

LEGISLATIVE BUDGET ANALYSIS 2005 BIENNIUM

Volume 1 - Statewide Perspectives

State Budget Outlook

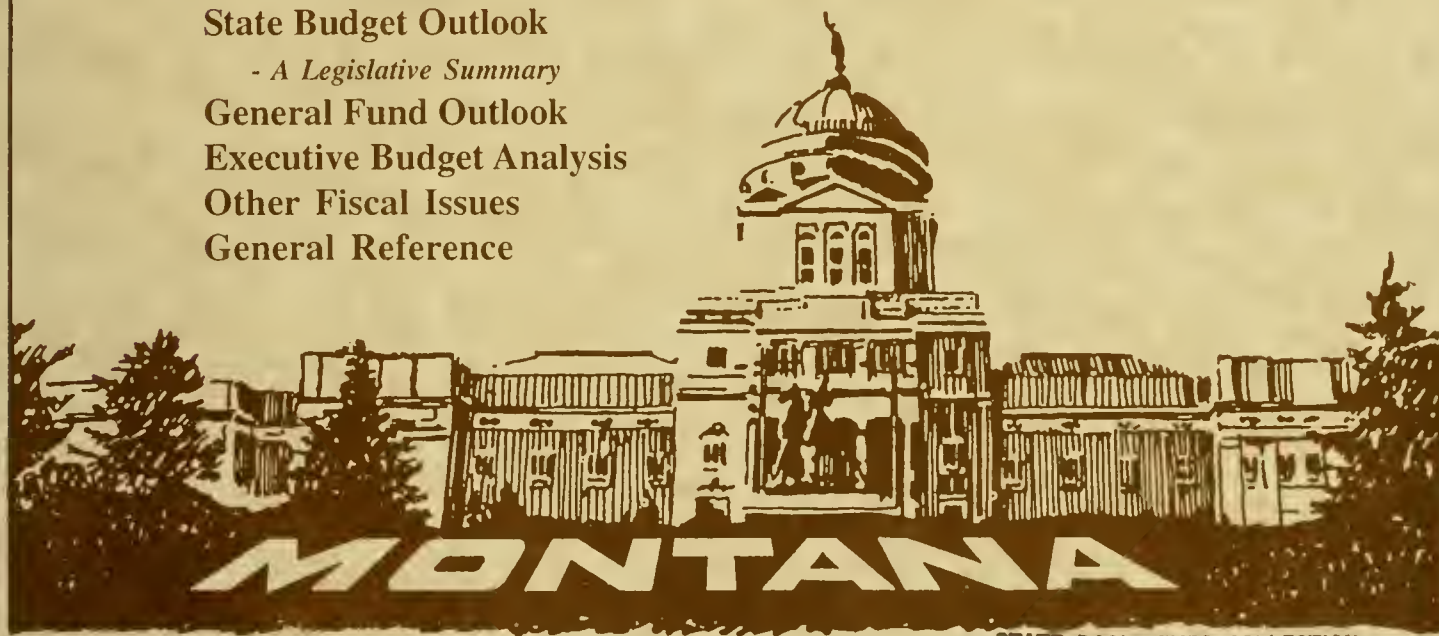
- *A Legislative Summary*

General Fund Outlook

Executive Budget Analysis

Other Fiscal Issues

General Reference



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LEGISLATIVE BUDGET ANALYSIS

2005 Biennium

Volume 1 – Statewide Perspectives

Presented to the Fifty-eighth Legislature

Submitted by

The Legislative Fiscal Division

Helena, Montana

January, 2003



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December 2002

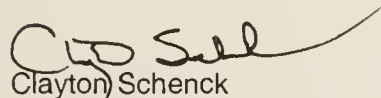
Members of the Fifty-eighth Legislature:

I submit for your consideration a fiscal analysis of the state budget outlook for the 2005 biennium and Governor Martz's Executive Budget. It is our goal that this analysis will provide the information and insight necessary for legislators to craft an effective state budget and fiscal policy for the 2005 biennium. This four-volume report includes:

- Volume 1: Statewide Perspectives – This volume provides a summary overview of the state fiscal outlook and the executive budget analysis as well as a general reference section.
- Volume 2: Revenue Estimates – This volume provides the revenue estimates and underlying economic assumptions included in the revenue estimate resolution (HJR 2), and is designed as a working document for the taxation committees.
- Volumes 3 and 4 – These volumes are designed to serve as working documents for the appropriations subcommittees. They provide:
 - The Governor's agency budget recommendations, and
 - The Legislative Fiscal Division's detailed descriptions and analysis of the various components of the Executive Budget.

Your staff of the Legislative Fiscal Division look forward to being of service to the legislature during the 2003 session. We welcome any opportunity to assist you in obtaining the best possible fiscal information to facilitate setting fiscal policy. Staff names, assignments, and phone extensions are listed on page xiii. Please feel free to call on us!

Respectfully submitted,


Clayton Schenck
Legislative Fiscal Analyst

This analysis was created
In accordance with Section 5-12-302, MCA
by the Legislative Fiscal Division.

I am deeply indebted to an exceptional LFD staff
for their thousands of extra hours
and personal sacrifice in preparing this analysis.
Their dedication and professionalism
are a credit to the Legislature and the citizens of Montana.

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for their gracious cooperation
in this budget analysis effort.

Thanks also to
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of the Publications and Graphics Bureau
for exceptional customer service
in publishing this report.

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HOW TO USE THIS REPORT

The *Legislative Budget Analysis, 2005 Biennium* is published in four volumes. The report is designed to assist the 2003 legislature in setting fiscal priorities and to help legislators reflect those priorities in the 2005 biennium General Appropriations Act (HB 2).

Volume 1

Volume 1, which includes a legislative summary, provides an overview of the proposed budget. *Volume 1* also summarizes significant fiscal issues that may impact more than one agency or that do not fall under the jurisdiction of a single appropriation subcommittee. Generally, this volume attempts to answer the following questions:

1. What is the state's fiscal condition?
2. What are the major fiscal challenges facing the 2001 legislature?
3. What is the executive proposing for the 2003 biennium?
4. What are the significant issues identified by the LFD analysis?
5. What other fiscal issues are important to consider?

The "State Budget Outlook" section on pages 1 through 26 provides a high level summary of the material presented in *Legislative Budget Analysis*.

This volume is structured to present a general fund outlook for the 2003 biennium and 2005 biennium, an analysis of the *Governor's Executive Budget* proposals including issues identified by the LFD analysis, and a discussion of other fiscal issues that are related to the budget deliberations. The reference section, at the end of *Volume 1*, presents a range of budget-related material. This section is considered especially useful for new legislators and those who have not previously had direct involvement in the appropriations process.

An index in the back of *Volume 1* is the most comprehensive for the purpose of searching for information in all four volumes.

Volume 2

Volume 2 includes a summary and overview of the state's major revenue sources. A review of the table of contents will give the reader a quick idea of revenue sources included and the structure of the report. This volume will be provided to the House and Senate Taxation committees for use as a working document, and delineates the economic assumptions used to derive revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC) and introduced in the revenue estimate bill (HJR 2).

Volumes 3 and 4

Volumes 3 and 4 offer detailed analyses of individual agency budgets, as proposed through the Governor's Executive Budget submitted in mid-November. These volumes feature program-by-program detail, as well as the LFD analysis of each agency budget. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

Volume 3:

- A – General Government and Transportation
- B – Health and Human Services

Volume 4:

- C – Natural Resources and Commerce
- D – Corrections and Public Safety
- E – Education
- F – Long-range Planning

A specific agency can be located in any of three ways. The general index included in each volume provides an alphabetical listing of agencies and other topics, in conjunction with appropriate volume and page numbers. If the subcommittee addressing a given agency is known, the cover page of each section lists agencies, in order by appearance. Agency names are also visible on page headings within their respective sections.

Volumes 3 and 4 briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the analysis is consistent across agencies. These volumes detail an agency's requests, as well as a list of proposals and issues significant to the agency. When appropriate, there may be discussion of circumstances that could hold budgetary impacts (e.g., proposed executive legislation or agency reorganization). These volumes also present detailed discussions of present law adjustments, new proposals, and significant issues facing the various agencies as identified by legislative fiscal analysts.

Agency budgets are presented in three tiers as required by statute:

1. **Base budget:** the level of funding authorized by the previous legislation;
2. **Present law base:** the additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature; and
3. **New proposals:** requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, legislators can use the “base budget” as the starting point, then to follow the incremental increases that result in a total budget request for an agency.

Proprietary Rate Setting

HB 576 (1995) removed the requirement that proprietary – or internal service and enterprise – funds be appropriated by the legislature. Instead, the legislature approves the rates charged for those particular services and products. HB 576 also requires the Office of Budget and Program Planning to submit a report as part of the Executive Budget. This report includes fees and charges, projected fund balances, retained earnings, and contributed capital for providers. Although the legislature does not appropriate funds for the operation of these programs, it does approve the rates charged. These reports and the LFD analysis of the reports are included in the agency presentations in volumes 3 and 4, as appropriate.

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STATE BUDGET OUTLOOK

A Legislative Summary

Introduction

Economic Overview

State Fiscal Picture

Major Fiscal Challenges/Solutions/Issues

Executive Budget Highlights

Other Fiscal Issues

We're Not Alone – Other States' Deficits



What is the state budget outlook?



INTRODUCTION

For the first time in over a decade, Montana is experiencing a substantial general fund budget shortfall, estimated at \$230 - \$250 million for the biennium relative to present law budget requirements. The cause of the deficit is primarily due to: 1) a sharp decline in individual income taxes on and capital gains; 2) a decline in corporation income tax; and 3) an increase in state expenditures driven by human service caseloads and medical costs. In this challenging fiscal environment, the 58th Legislature faces the daunting task of developing a budget that preserves funding for the state's highest priority services, but also addresses the large deficit.

In this first chapter, we provide an executive summary of the state budget outlook. It includes a state economic overview, how those economic conditions affect the state fiscal outlook and the general fund budget in particular, the projected deficit, and the proposed executive budget solution/highlights. We then summarize the major fiscal challenges this legislature faces, the executive response/solutions to the challenges, and issues regarding those challenges/solutions. Other significant fiscal issues facing this session are also highlighted, as well as a brief summary of other states' budget woes and solutions to the nationwide state budget crisis.

In a nutshell, this section provides summary answers to the following questions:

- What is the current economic profile of Montana?
- What is the state's fiscal condition?
- What is the projected budget deficit?
- How does the executive propose to solve the deficit?
- What are the key features of the executive budget?
- What are the major fiscal challenges facing the 2003 legislature?
- What are the executive solutions?
- What are the significant issues identified by the LFD analysis?
- What other fiscal issues are important to consider?
- Where did we go wrong? Is the budget crisis unique to Montana?

The majority of the issues discussed in this overview are discussed in more detail in the remaining chapters.

What is the current economic profile of Montana?



MONTANA ECONOMIC OUTLOOK

Montana state government, like any other business, is influenced by economic and demographic developments. For example, Montana's economic base as well as the strength of the U.S. economy determines the level of revenues collected from personal and corporate income taxes, property taxes, natural resource taxes, and investment earnings. Similarly, both economic and demographic variables affect state government disbursements for education, human services, corrections, and other governmental services.

Montana's total revenue base is comprised of a number of taxes and fees plus numerous federal reimbursements or grants. Revenues are further enhanced from the investment of trust monies and idle cash pending disbursement from the state treasury. Since individual income tax is the state's largest general fund tax source, economic developments or trends in the areas of employment and income levels significantly influence available revenues to fund governmental services. Federal revenue correspondingly is used to fund a number of human service, transportation, and educational services. In a number of instances, general or state special revenue fund dollars are required to provide a state match before the federal funds can be disbursed.

Conversely, Montana's total expenditure base is targeted toward educational and human service programs with a significant allocation to highway construction. Education and human service costs are driven by some of the same economic and demographic conditions that influence state revenues. If employment levels increase, this usually translates to an increase in population or a reduction in unemployment levels. With population increases comes a corresponding increase in educational and human service costs. A greater population requires a better transportation system not only for the general populace but also for the businesses that expect to expand to meet the needs of an ever-growing population.

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. The future, however, does not look as good as the effects of a national economic recession, terrorism threats, and mid-east tensions play havoc on the US economy. All of these factors continue to weigh on the minds of investors, which is reflected by the bearish mood on Wall Street.

During calendar 2001, the Federal Reserve Board (FED) reduced interest rates 12 times in an attempt to stimulate the US economy. On November 6, 2002 the FED reduced interest rates further with an additional half point reduction. Many economists are now suggesting that the interest rate reductions may have little affect on the economy, since many businesses are reluctant to invest in business

expansion and possess minimal control to increase prices. Many of the earnings reports issued by major US companies show slow growth and reduced revenues as the result of a sluggish economy. These trends translate to a similar slow-down in Montana's economy. Montana's economy is highly dependent on agriculture, tourism, natural resource extraction, and mining. All of these industries produce residual wholesale/retail trade and service sector jobs. If the basic industries are not flourishing, other sectors suffer as well. And if Montana's economy slows, tax revenue growth usually follows the trend because of the state's dependence on income tax revenues.

The irony of an economic slowdown is the inverse effect it may have on state expenditures. For example, if unemployment increases, this may translate into a greater demand for human service benefits and a greater need for correctional facilities and services. During a period when revenue growth is slowing, governmental service demands may actually increase at a faster rate.

The economic outlook for the state is very fragile at this time. Employment and wage indicators continue to support slow growth in the near-term with the prospect of a gradual recovery by 2005. Capital gains income is expected to further erode during calendar 2002 and 2003 with a return to pre-technology exuberance trends for calendar 2004 and 2005. While interest rates are at historic lows, corporate profits are expected to remain soft. Property values are expected to increase due to reappraisal. The 58th Legislature, however, may need to address this issue depending on the magnitude of the increases. The effects of lower interest rates may have some beneficial impacts on economic growth at the expense of reduced state revenues from investments.

What is the state's fiscal condition?

What is the state's projected budget deficit?



STATE FISCAL PICTURE

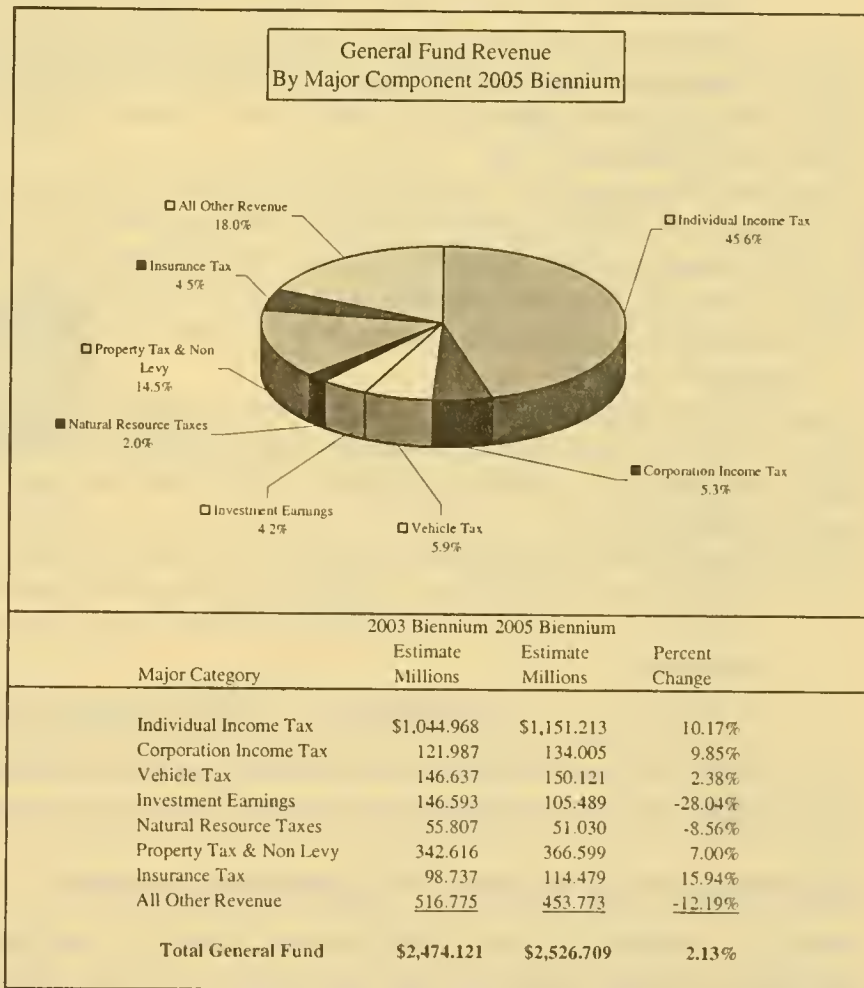
STATE FISCAL OUTLOOK

The previous section described the economic outlook for Montana from the perspective of how economic activity at both the state and national level impacts state revenues and expenditures. This section describes in more detail how those economic conditions determine the state fiscal outlook and ultimately the size of the 2005 biennium budget.

GENERAL FUND REVENUE IMPLICATIONS

Montana's fiscal outlook for revenue growth is much less optimistic than in previous biennia. The preliminary revenue estimates adopted by the Revenue and Transportation Interim Committee (HJR2) are based on a slowing economy through calendar 2003 with a gradual recovery by calendar 2005 at both the national and state levels.

As shown in the pie chart at the right, individual income tax, corporation income tax, property tax, vehicle tax, and investment earnings are expected to contribute over 75 percent to the total general fund revenue stream during the 2005 biennium. Total general fund revenues for the 2005 biennium are projected to increase 2.1 percent over the 2003 biennium projections. The comparative change by major revenue category is shown at the bottom of the figure.



House Bill 7, enacted during the August special legislative session, created a new state special guarantee account, which receives deposits of interest and income, timber, and mineral royalty revenues from school lands. These monies were previously deposited in the general fund. This means that revenues for the 2003 biennium include school land revenue for fiscal 2002, but these funds have been removed for fiscal 2003. If the fiscal 2002 amount is adjusted to exclude this revenue, the adjusted general fund growth rate is projected to be 4.2 percent from the 2003 to 2005 biennium.

The key economic assumptions targeted as most affecting state government receipts are Montana total income (all sources reported as individual income tax income), employment and population levels, inflation rates, corporate profits, property values, interest rates, and energy prices. The impacts of the current economic situation are reflected in the assumptions that were used to derive the revenue estimates and key factors are briefly highlighted below. A more complete summary can be found on page 27 of this volume, and a detailed explanation for each revenue component is in Volume 2, "Revenue Estimates".

- Wage and salary income provides the largest portion of Montana total income. Average growth has been 5.5 percent over the past decade. For calendar 2002 and 2003, growth is slow, gradually increasing to about 5 percent by calendar 2005.
- Capital gains income increased sharply in relative importance during the 1990s, growing from 4.2 percent to 9.2 percent of total income. In 2001, capital gains income dropped by nearly 38 percent over 2000, and is projected to decline an additional 28 percent in calendar 2002. They are expected to remain flat in 2003, then "rebound" to a historic growth rate of 7.5 percent per year in 2004 and 2005.
- Average annual growth in employment has been 2.0 percent since 1996. In the forecast period, growth is gradual, from 0.8 percent in calendar 2002 to 1.8 percent in calendar 2005.
- Population growth was 2.3 percent in 1998, and is estimated at 0.9 percent annually in the next biennium. This factor impacts many of the consumption taxes.
- Since 1990, inflation has averaged 3.0 percent annually and is estimated at 2.9 percent during the next biennium.
- Between 1990 and 1997, U.S. corporation tax profits increased an average 3.9 percent per year, but have decreased an average 3.9 percent annually from 1998 through 2001. The decrease is expected to continue in 2002, and then begin a gradual recovery throughout the biennium.
- Property tax values increased slowly in the 1990s but fell in fiscal 2000 and 2001, primarily due to legislative tax changes. Estimates for the 2005 biennium show a resumed slow upward trend. The effects of the reappraisal cycle have not been included in the HJR2 revenue estimates.
- Interest rates dramatically declined beginning in January 2001, but rates are expected to begin an upward trend during the forecast period as the national economy recovers.
- Estimates show a slow decline in the prices of coal, natural gas, and oil during the forecast period. If a U.S. war with Iraq materializes, energy prices could mushroom during the conflict.

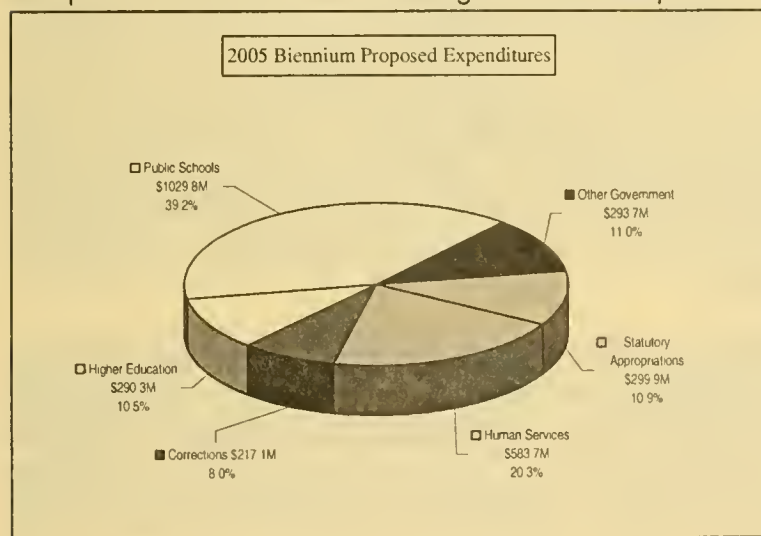
GENERAL FUND EXPENDITURE IMPLICATIONS

Montana's expenditure growth, like revenue growth, is responsive to economic and demographic conditions. While income levels, commodity prices, and interest rates influence revenue trends significantly, expenditure trends are more susceptible to population trends and demographic characteristics. Inflation rates also significantly impact expenditure trends, but are not a good overall measure of expenditure trends.

As discussed previously, total population growth trends in recent years have abated from historical levels and are expected to grow at only 0.9 percent per year throughout the next biennium. Even with a slower growth rate, the demand for state services continues to increase. Depending on the demographics (age, income, etc.) of the population base, the demand for government services will emerge in the form of increased school enrollments, caseloads, or government employee workload. Demographics play a significant role in determining the cost of governmental services. With a shift in age demographics, school populations have declined while human services and corrections populations have grown. "Baby boomers" will continue to place increased pressures on government social programs as they enter their senior years. And in general, economic downturn results in higher demand for government services, exacerbating budget woes in times of declining revenues.

Additionally, Montana is a large state with a sparse population. One implication of this characteristic relates to how its citizens access government. Some state programs, because of the nature of their services, must maintain a presence in numerous communities in order to ensure access. Others have used information technology to provide citizens with access to governmental services. Merely providing government access will require either more services provided locally or the expansion of information technology capabilities.

The pie chart to the left shows the general fund expenditures, as proposed for the 2005 biennium in the executive budget. As shown, education (K-12 and higher education), human



services, and corrections comprise 78 percent of the general fund budget. These components are driven by demographics, population, and other factors that drive caseload, student enrollment, and prison population. The statutory appropriations component is predominantly local government assistance and debt service on state indebtedness. All other parts of state government (over 20 agencies) comprise only 11 percent of the general fund budget.

GENERAL FUND ECONOMIC IMPLICATIONS – SUMMARY

In summary, revenue growth is expected to slowly recover in the 2005 biennium from the significant declines in the 2003 biennium. However, this rate of growth is not expected to be nearly as strong as observed during the late nineties. This premise is based on slower growth in income tax revenues with a property tax base that is increasing but still below the fiscal 2000 level. Capital gains income is not expected to return to the historic levels of the late nineties, signifying a permanent loss of revenues.

The cost of governmental services will continue to increase even with a moderate rate of inflation and a slow growth rate in total population. School enrollments are declining, yet costs to support public schools continue to increase because of the relative weight of labor costs. Human services costs will continue to escalate because of greater caseload demands and higher medical costs.

Overall, the budget picture is serious when viewed from a perspective of funding existing services. This means there are insufficient revenues to fund present law services and leave an adequate ending fund balance or reserve. The legislature will be faced with significant challenges to balance the budget while ensuring long-term structural balance and to address the issues of economic development, educational funding, tax reform, and rising human services costs.

GENERAL FUND STATUS

The previous sections described the economic outlook for Montana and how those economic conditions determine the state fiscal outlook. This section looks at the specific general fund projections for the current biennium, and ultimately the size of the 2005 biennium budget, in view of the existing and forecasted economic conditions.

BUDGET SHORTFALL: HOW WE GOT HERE

For nearly a decade, states enjoyed a strong state budget picture. In the late nineties, the underestimation of capital gains taxes due to robust equity markets was the norm and contributed to a significant increase in state surpluses. States however, were caught off guard when the national economy went into a recession in early 2001, further aggravated by the unpredictable events of September 11. States with sales taxes and large manufacturing sectors felt the impact first, while states like Montana, with a high dependence on income taxes, did not feel the full impact until calendar 2002. The mild recession on the national level has hit states much harder than the more severe recession of the early 1990s. This is explained by the ever increasing proportion of state revenues realized from capital gains taxes during a period of unprecedented growth in equity markets. While some budget experts anticipated a slowdown in capital gains revenues, very few expected revenues would decline so severely. Montana's state budget decline has been below the national average, yet there has been a dramatic reduction in revenues that did not become fully apparent until the filing of income tax returns reached its peak in mid-2002.

In November 2001 and in a series of reports since then, this office reported to the legislature that Montana was experiencing a sharp decline in general fund revenues. In April 2002, the Governor's Office formally announced concerns about a budget deficit, and initiated proceedings to implement spending reductions in accordance with 17-7-140, MCA. On June 22, the Governor directed spending reductions of \$23 million and at the same time called for a special session of the legislature to deal with a budget deficit.

The following discussion provides pre-special session projections of the general fund deficit, a summary of legislative actions taken, and the revised projected ending fund balance for the 2003 biennium.

2003 BIENNIUM – DEFICIT/SOLUTIONS

The 57th Legislature adjourned the 2001 session with a 2003 biennium budget that provided for a projected general fund reserve of \$54 million (2.3 percent of biennial appropriations). The revenue estimates assumed a less robust growth pattern than immediate past biennia, but still a consistent growth. For the first several months following the 2001 session, state general fund revenues came in even stronger than projected in the revenue estimate resolution for fiscal 2001, resulting in \$62 million more than anticipated. Revenues then held steady in early fiscal 2002. In November 2001, our office reported a significant downturn in general fund revenues and in the last half of fiscal 2002, revenues

dropped off from regular session estimates by \$153 million. Individual and corporate income taxes were the reason for the shortfall, dropping off by \$123 million and \$33 million, respectively, while all other revenue components combined were up a net \$3 million. Although cushioned by an unexpected surplus in fiscal 2001, the revenue shortfall left a gap of \$90 million, and placed the projected balance in a deficit situation.

Facing a projected ending fund balance of what ultimately turned out to be a negative \$42 million, the Governor directed statutory spending reductions of \$23 million, and called the legislature into special session to fill the remaining gap to achieve an acceptable ending fund balance reserve. The legislature adopted \$59 million in budget balancing actions, leaving an ending fund balance projection of \$40 million. Allowing a reserve of \$13 million for the 2003 session costs and anticipated supplementals, the projected ending fund balance was \$27 million. This was approximately \$1 million above the statutory minimum fund balance of \$26 million as specified in 17-7-140, MCA.

The solutions in the special session included a number of one-time solutions and a number of reductions that would only become permanent if acted upon by the 2003 legislature (i.e., they still remained a part of the budget base).

2005 BIENNIUM – PROJECTED DEFICIT

Utilizing a high fund balance combined with the Governor's and legislative reductions provided a short-term solution to the general fund shortfall in fiscal 2003. It was clear at the time, however, that falling revenues and an on-going expenditure base for government services that exceeded projected revenues would leave a significant 2005 biennium deficit for the 58th Legislature. The 2001 legislature had approved a budget in regular session that was structurally imbalanced – that is, the ongoing expenditure base exceeded projected revenues by over \$50 million. This shortfall, combined with the sharp decline in projected revenues, left a large deficit when comparing available revenues to the cost of continuing present law services.

As shown in Figure 1 on the next page, the projected present law ending general fund balance for the 2005 biennium is a negative \$232.0 million, which includes a \$50.1 million ending fund reserve. This estimate is based on revenue estimates as adopted by the Revenue and Transportation Interim Committee on November 19, 2002, and the cost of operating state government based on present law requirements as derived from the Executive Budget. This projection provides a stark contrast to the \$53.8 million balance the 2001 legislature originally anticipated at the end of the 2003 biennium, and leaves insufficient funds to even continue existing programs and services at present law levels. The primary reasons that have contributed to this outlook are a significant decline in actual and projected general fund revenue collections (primarily individual and corporation income taxes) and an increase in present law human service, corrections, and other costs.

Figure 1
2005 Biennium General Fund Balance
Present Law Only
 In Millions

	Estimated 2005 Biennium
Beginning Fund Balance	\$4.357
Revenues	
Current Law Revenue	<u>2,526.709</u>
Total Funds Available	\$2,531.066
Disbursements	
General Appropriations	
Human Services	583.665
Corrections	217.133
Higher Education	290.256
Public Schools	1,029.848
Other Government	293.699
Statutory Appropriations	268.118
Non-Budgeted Transfers	31.780
Feed Bill Appropriations	6.699
Anticipated Reversions	<u>(8.191)</u>
Total Disbursements	\$2,713.007
Ending Fund Balance Before Reserve	(\$181.941)
Proposed Executive Budget Reserve	(\$50.060)
Projected Present Law Deficit	(\$232.001)

The provision of a present law budget projection represents a starting point for legislative budget deliberations, and complements the statutory requirement that the executive and legislative staff present and analyze a present law budget. Present law is defined as "that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature..." Present law serves as a benchmark to aid the legislature in prioritizing budget issues between maintenance of existing services and provision of new services.

It is clear that anticipated funds will not support continuation of existing present law services. By statute, the executive must develop a present law budget in addition to new initiatives and/or reductions that fulfills the constitutional mandate of a balanced executive budget proposal. The executive budget proposal includes a number of new proposals that provide additional general fund revenue but also reduces the level of services provided by governmental entities. The combined impact of these proposals eliminates the present law deficit and leaves the general fund balance at \$36.0 million by the end of the 2005 biennium.

It has become clear that the state general fund tax base has declined, primarily with regard to individual and corporate income tax revenues. The prevailing question is how soon and to what extent the tax base will recover. It is now clear that the revenue bubble from capital gains income growth has burst, resulting in a permanent reduction in the general fund revenue base. In order to avoid a continued structural imbalance, the legislature will have to focus on long-term solutions to the current budget deficit.

A more detailed discussion of the general fund deficit is on page 45 of this volume.

How does the executive propose to solve the deficit?
What are the key features of the executive budget?



EXECUTIVE 2005 BIENNIUM BUDGET HIGHLIGHTS

INTRODUCTION

As outlined in the preceding sections, a revenue shortfall and budget deficit of \$232 million face the 58th Legislature, as receding revenues do not leave enough to continue even present law services. This section turns to the Governor's proposed budget solutions, and is divided into two parts:

- Governor Martz's response to the state fiscal outlook -- that is, an overview of how the Governor proposes to eliminate the present law deficit, which is presented in more detail in the "Executive Budget Analysis" (page references are provided in Figure 2 on the next page).
- A brief highlight of Governor's Martz's policies and priorities in building the state budget for the 2005 biennium.

DEFICIT REDUCTION PROPOSALS

Figure 2 provides a summary of the budget balancers proposed in the Executive Budget that are intended to resolve the \$232 million deficit and provide for a balanced budget for the 2005 biennium.

As shown in Figure 2, the executive budget includes \$218 million in deficit mitigation measures (budget balancers) to resolve the \$232 million deficit. The \$232 million deficit projection assumes a \$50 million ending fund balance reserve, and since budget balancers are \$14 million less, the ending fund balance would only be \$36 million (the difference of \$14 million is largely due to lower revenue estimates adopted by the Revenue and Transportation Interim Committee in HJR 2, which were used to calculate the \$232 million deficit).

The \$218 million in budget balancers (shown in the shaded area of Figure 2) include a net \$102 million in expenditure measures and \$115 million in revenue solutions. Transfers from other funds, such as the coal tax trust transfer, are included as revenue solutions.

The most significant budget balancers are:

- \$103.5 million in transfers from other funds, including the coal tax trust and state fund
- \$21.1 million in fund switches
- \$38.6 million in identified service reductions
- \$58.3 million in miscellaneous and unspecified reductions
- (i.e., the executive does not generally identify what services will be reduced or the impact of the reductions)

Figure 2 Executive Proposed Deficit Mitigation Measures 2005 Biennium (millions)			
Component	Detail Subtotal	Total	Page Number
Projected Deficit		\$ (232.0)	45
Ending Fund Balance Target Included in Projection		<u>50.1</u>	
Deficit Without Ending Fund Balance Projection		\$ (181.9)	
BUDGET BALANCERS			
Revenue Proposals			
Fund Balance Transfers		\$ 103.5	
State Fund	\$ 17.3		75
Permanent Coal Tax Trust (net of interest impact)	86.3		79
Diversions to the GF - Extend Coal, Oil & Gas, Metal Reallocations*		8.3	77
Oil and Gas Accrual		3.0	78
Terminate Infrastructure Credit		2.0	79
Coal Tax Trust Reallocation		(0.5)	77
Revenue Reduction due to Expenditure Proposals		<u>(0.9)</u>	85
Total Revenue Measures		115.4	
Disbursement Proposals			
Cultural and Aesthetic Grants		(0.5)	E-56
Eliminate Current Transfers from the General Fund		14.4	
Transportation (for Motor Vehicle Div.)	6.0		76
Research and Commercialization/Growth Through Agriculture*	8.4		76
Pay Plan Proposal/Personal Services Contingency		(9.7)	95
HB 2 Reduction Measures		120.6	
Fee Increases	2.7		106
Funding Switches	21.1		109
Specific Service Reductions	38.6		105
Miscellaneous/Other Unspecified Reductions	58.3		70, 122
HB 2 New Proposals (positive)		<u>(22.2)</u>	
Total Disbursement Measures		\$ 102.6	
Total Executive Deficit Mitigation Measures		\$ 217.9	
Projected Actual Ending Fund Balance - Executive Budget		<u>\$ 36.0</u>	
*Some reductions in service will also result.			
**The executive offset enrollment increases with a like reduction in the same decision package. If the enrollment had been appropriately added in present law and reduced in a new proposal, the resulting unspecified reduction would total \$25.4 million.			

A page reference at the right of each item listed in Figure 2 directs the reader to a further description of each item.

GOVERNOR'S BUDGET POLICIES AND PRIORITIES - HIGHLIGHTS

This section provides a brief overview of the overall budget policies and priorities in the Martz budget to fund state government. Revenue proposals are discussed in more detail in the "Executive Revenue and Tax Policy Proposals/Issues" section on page 75 and expenditure proposals are summarized in the

"Executive Expenditure Proposals - Summary" section on page 63. Following are highlights of key issues of the budget.

Total Budget Summary

The Executive Budget proposal totals \$6.8 billion for all funds, of which \$2.6 billion is general fund. The executive includes total spending increases for the 2005 biennium (as compared to the 2003 biennium) of \$45.4 million general fund and \$471.5 million total funds (as adjusted for a fund switch for K-12 education). This represents biennial increases of 1.8 percent general fund and 7.5 percent total funds. General fund is distributed as follows:

- 50 percent goes to education (K-12 and higher education)
- 20 percent goes to human services
- 8 percent goes to corrections.
- 11 percent goes to local government assistance, debt service, and other statutory appropriations
- 11 percent goes to all other government (over 20 agencies)

Highlights Of Revenue Proposals

The Executive Budget includes over \$100 million in revenue proposals, which are almost exclusively for the purpose of generating general fund savings/new revenue.

- There are no tax proposals in the Executive Budget that address tax policy or new initiatives (except for the Governor's proposed income tax/sales tax reform package, which is not part of the published Executive Budget)
- The revenue proposals are largely one time sources of funds intended to generate general fund savings, and include:
 - Extending a number of temporary revenue actions enacted by the legislature in the August 2002 special legislative session to help balance the general fund budget
 - Transfers from other funds, including the coal tax trust and state funds (\$110 million)

Highlights Of Expenditure Proposals

The 2005 biennium executive expenditure proposals are defined by a series of additions and reductions in varying sizes and impacts among all agencies. Few functions of state government are eliminated or significantly reduced, and these are primarily concentrated in human services programs. LFD staff has attempted to ascertain anticipated impacts on services in the narratives related to specific agencies in Volumes 3 and 4.

The following summarizes the primary factors of the HB 2 (general appropriations act) portion:

- General fund increases by a net \$54.5 million from the 2003 biennium -- The increase is dominated by funding for costs of state assumption of district courts and by population increases in corrections.
- Present law changes are dominated by three factors:
 - Increases for statewide present law adjustments (including full funding of personal services less vacancy savings, fixed costs, and inflation)
 - Caseload and enrollment changes
 - Reductions to continue the Governor's 17-7-140 spending reductions.

- General fund new proposals are dominated by reductions to meet general fund reduction targets within individual agencies. New proposal *increases* add a total of \$22.2 million general fund, but are dwarfed by reductions of \$86.9 million.
 - General fund new proposals for reductions lack a clear executive policy specification.
 - New proposal increases are:
 - To replace funding and address caseload increases in foster care
 - For developmental disabilities services (in part due to federal funding reductions)
 - To provide \$6.0 million for schools.
- Program funding highlights include the following:
 - Human services would receive a relatively low, 1.1 percent general fund increase, reflecting otherwise significant caseload and health care cost increases that are offset by extensive budget balancing benefit reductions
 - An overall slight reduction in general fund/state special revenue spending for K-12 education in the 2005 biennium, reflecting declines in ANB, but allowing averaging of ANB in fiscal 2005 and other education policy initiatives
 - Higher education is held to virtually the same level of general fund as for the 2003 biennium, while total funds decrease \$5 million – No increases are provided for enrollment growth or other present law adjustments
 - Corrections receives a \$15 million, 7.5 percent increase, largely for population increases
- FTE increase by a net of 110.02 FTE in fiscal 2004 and 56.84 FTE in fiscal 2005 -- This total is the net after reductions in a number of agencies (156.87 FTE in fiscal 2004 and 213.00 FTE in fiscal 2005) -- Decreases are primarily general funded positions and increases are primarily positions funded from other funds.

There are other components of the executive proposal, not included in HB 2:

- Local government entitlements increase by \$7.5 million for inflation, and do not participate in state shortfall cutbacks
- The employee pay plan (HB 13) includes only an increase in the state's share of the employee health insurance at a cost of \$8.5 million general fund and \$11.7 million other funds.
- Supplemental appropriations requests for fiscal 2003 (HB 3 and HB 16) total \$14.5 million general fund, with a \$1.2 million contingency not in the bills, but in the executive balance sheet.
- Statutory appropriations and local assistance have a total estimated cost of \$394 million.

What are the major fiscal challenges facing the 2003 Legislature?
What are the Executive solutions?
What are the significant issues identified by the LFD analysis?



MAJOR FISCAL CHALLENGES / SOLUTIONS / ISSUES

As discussed previously, the 2003 legislature will convene facing the worst budget deficit in years. Revenue forecasts indicate insufficient revenues to support even present law expenditures, let alone the pressures of increased caseloads, growing prison populations, and demands for more money for schools. The volatility of revenues and an expected slow economic recovery add to an already dismal scenario for the 2005 biennium. What makes this shortfall worse than others is that most of the “easier” solutions were used in the fiscal 2003 Governor’s Spending and August 2002 Special Session reductions.

Therefore, it appears that the upcoming legislature will face many challenges in their deliberations. To put the economic and fiscal picture presented in prior sections in perspective, the following summarizes key challenges and uncertainties that they will have to consider in formulating the 2005 biennium spending plan and related fiscal issues. Below each is a summary of the executive proposed solution and issues raised by the LFD analysis where appropriate.

Fiscal Challenge

A significant budget deficit will leave the 58th Legislature with a projected shortfall that falls \$232.0 million short of the amount needed to continue present law services. The legislature will have to either significantly reduce existing government services or provide additional revenues to fund existing services.

Executive Proposal: The executive budget proposes a combination of \$102.6 million in expenditure reductions and \$115.4 million in revenue adjustments to fund the 2005 biennium budget. The revenues include the transfer of a net \$86.3 million (net after interest lost) from the Coal Tax Trust Fund and \$17.3 million from the State Compensation Insurance Fund (“old fund”).

Issue: The executive budget as proposed would provide for a balanced budget, but would require a 3/4 vote of the legislature to authorize the transfer from the Permanent Coal Tax Trust. Although several attempts have been made to transfer these funds for direct operational expenditures, none have ever been successful.

Issue: At least \$50 million in proposed expenditure reductions lack specificity in what service or operations reductions would be necessary or the impacts. This denies the legislature the information necessary for determining policy and prioritizing services.

Fiscal Challenge

Economic uncertainties continue to undermine revenue-forecasting efforts, and contribute to an increased demand for government services in the areas such as human services and corrections.

Executive Proposal: Although there is a great deal of concern about the ability of general funds to recover in the near term, the executive budget assumes a relatively strong recovery by fiscal 2005. On the program side, the executive proposes approximately \$38.6 million in specific services reductions and another \$58 million in unspecified reductions, with significantly reduced eligibility and benefits in health care services.

Issue: Given the signs of a sluggish national economy and the inherent increase in government services demands and eligibility, are revenue estimates conservative enough, and can tight budgets in human services and corrections be sustained without cost over-runs?

**Fiscal
Challenge**

Adequacy of the ending fund balance reserve will need to be evaluated by the legislature in the wake of reduced revenue growth and budget balancing reductions. What will it take to ensure that Montana has an adequate “safety net” in place?

Executive Proposal: The Executive Budget includes a general fund ending fund balance at the end of fiscal 2005 of \$50.1 million, or about 1.9 percent of total proposed general fund appropriations. Using HJR 2 revenue estimates, the executive budget leaves a balance of only \$36 million.

Issue: In consideration of economic uncertainties and the lack of a budget for wildfire suppression, the LFD suggests 2.5 percent of ongoing revenue reserve as a minimum, which would translate into a \$65 million ending balance. National fiscal experts recommend a balance of 3 to 5 percent. Besides the typical reserve, another possibility is establishment of a “rainy day” fund as used in 46 other states.

**Fiscal
Challenge**

Controlled budget growth (structural balance) will continue to be a concern if revenues fall short of expectations and “one-time revenue” fixes are used to fill gaps in the shortfall. A widening structural imbalance can translate into continuing budget problems for the legislature in future biennia.

Executive Proposal: The executive proposal would leave a projected structural imbalance in fiscal 2005 of \$34 million (ongoing expenditures exceed ongoing revenues).

Issue: With the likelihood that state revenues will not experience similar growth rates of the late nineties, the legislature should consider long-term solutions to provide a permanent solution to the budget shortfall.

**Fiscal
Challenge**

The **fiscal 2003 budget shortfall**, although addressed by the August special session, is not completely resolved. A combination of revised revenue estimates, higher than expected supplemental requests, and the passage of a voter initiative will reduce the 2003 projected ending cash and fund balance to a dangerously low level.

Executive Proposal: The executive projects an ending fund balance in fiscal 2003 of approximately \$6.0 million, whereas the LFD projects a \$4.4 million ending fund balance. This balance falls well short of the required statutory minimum fund balance of approximately \$26 million.

Issue: The legislature needs to examine whether additional budget balancing action will be required to provide an adequate ending cash and fund balance for the current 2003 biennium.

**Fiscal
Challenge**

Health care cost inflation and caseload increases continue to be major contributors to greater than average growth in health care services budgets. Double-digit increases in state health care costs are back after several years of moderate growth. Significant service reductions were implemented in fiscal 2002 to stay within budget, and budget reductions in fiscal 2003 provided more service cutbacks. Underestimating costs could result in a budget-breaking supplemental request or further reductions in health care services.

Executive Proposal: The executive budget includes significant services reductions, tighter eligibility criteria, and the refinancing of some services. The \$5.7 million general fund increase (0.6 percent) over the 2003 biennium is the net of adjustments for increased costs and caseload, offset by reductions in program operations and services. Increases in other funds of nearly \$217 million are primarily federal funds that relate to various programs such as Medicaid, food stamps, and bio-terrorism grants.

Issue: The major issue facing the legislature is structuring Medicaid funded programs to serve the most needy, vulnerable citizens, while limiting cost increases. The difficulties lie in choosing policies that:

- Do not shift costs to other entities, including functions that are 100 percent funded by the general fund or to counties
- Do not shift costs to other potentially more expensive components of the Medicaid program
- Are within federal criteria to maintain federal Medicaid participation
- Are equitable

Increasing health care costs impact other areas of the budget as well, such as the cost of employee health insurance and health care costs in institutions.

**Fiscal
Challenge**

Correctional system population continues to grow. Underestimating the growth could result in a budget-breaking supplemental request, and overestimating could skew the prioritization process, taking funding away from other program areas. In addition, a recent strategy of early release of prisoners, while providing some budgetary relief, might not result in the savings that was desired.

Executive Proposal: The executive budget proposes for corrections a \$14.7 million or 7.5 percent increase in general fund for the 2005 biennium. This is one of the largest general fund increases (dollars) in the Executive Budget. To date, no supplemental appropriation for fiscal 2003 has been requested for the Department of Corrections.

Issue: Managing this budget relies on continuation of conditional release strategies, which are accompanied by citizens' perceptions of public safety issues. The impacts of reductions to inmate services are unknown.

**Fiscal
Challenge**

Funding for schools is an ongoing concern. In recent years, public schools have been faced with declining K-12 enrollments and declining budget authority without equal reductions in costs. What steps can the state take to help resolve school funding problems and maintain its relatively high achievements in performance measures?

Executive Proposal: The executive proposal addresses declining enrollments and the problem of declining budget authority by proposing an increase in school district entitlements of 2 percent and 1 percent in fiscal 2004 and 2005. In addition in 2005, the executive proposes to allow districts to average ANB (Average Number Belonging) over a three-year period to mitigate the effects of declining enrolments.

Issue: ANB is expected to decrease about 3.4 percent over the two years of the biennium, lower than the proposed increase in entitlements of a little over 3 percent. The executive's proposal partially pays for the entitlement increase with a reduction in the direct state aid percent to 42.6 percent from 44.7 percent, thus increasing mandatory BASE aid taxes in the district general fund.

**Fiscal
Challenge**

Higher education has been funded to a greater and greater degree in recent biennia with increased tuition charges, as general fund becomes a smaller share of total funding. The legislature will need to reconcile the difference between what the total state funded share of higher education should be, and what the state can afford during these times of revenue limitations.

Executive Proposal: The proposed 2005 biennium Executive Budget for state support of higher education, at \$273.4 million, is \$3.8 million less than the 2003 biennium base (fiscal 2002 adjusted expenditures times two) and is as much as \$40 million less than the present law level acknowledged by the executive before application of budget balancing reductions.

Issue: The reductions in the executive budget are unspecified, and abandon the per student formula that has been used in the past. The reductions are not tied to the statewide policy goals and accountability measures adopted by the Subcommittee on Postsecondary Education Policy and Budget. The level of funding in the Executive Budget may again lead to tuition increases.

**Fiscal
Challenge**

State assumption of district courts has become a difficult issue for the Judiciary. The implementation of SB 176 (2001 session) has left many questions about who (state or local jurisdictions) should be paying for what. The fiscal 2002 base contained no district court expenditures, so a full biennium cost must be added to the 2005 biennium budget.

Executive Proposal: The executive recommended 2005 biennium budget for district court assumption is \$37.3 million, an amount that is dependent upon passage of legislation making counties responsible for variable costs above the appropriation.

Issue: The funding issue primarily pertains to the state's limited ability to control or predict those costs that vary with caseload, including juror fees, witness fees and expenses, and indigent defense costs in criminal felony cases. In addition, unanticipated costs of salary increases, rent, the judicial branch pay

plan, and operating expenses of new judges in Ravalli and Cascade counties have also contributed to a higher fiscal 2005 biennium budget.

**Fiscal
Challenge**

Local government assistance was restructured by the 2001 legislature, in an effort to provide stable revenue sources for local programs. Local government, however, is not necessarily immune to the budget woes of the state or the economic turmoil of the state and nation.

Executive Proposal: The executive proposes no change to current law in HB 124 entitlements to counties and cities, but proposes to delay the current law increase in HB 124 block grants to school districts and the countywide education accounts for two years. In addition, HB 124 block grants to district transportation and school facility accounts will be reduced.

Issue: County and city HB 124 entitlements will be \$7.5 million higher in the 2005 biennium than in the 2003 biennium. Under the governor's proposal, HB 124 block grants to schools will drop around \$12 million, although nearly all of this will be redistributed to districts based on number of students or on school facility debt service needs. The legislature needs to consider how this proposal fits with other budget balancing priorities.

**Fiscal
Challenge**

Economic development has been a high priority for the Martz administration. As the state attempts to address its economic climate, budget woes are causing state investments in economic development activities to shrink, while Montana continues to rank near the bottom in per capita income and other economic indicators.

Executive Proposal: \$8.4 million general funds and \$9.4 million other funds is proposed by the executive for economic development programs in the Governor's 2005 biennium budget. This includes an \$8.0 million general fund decrease and a \$1.3 million decrease in other funds as compared to the current biennium. Most of the general fund decrease occurs in the elimination of a statutory allocation of monies for research and commercialization grants.

Issue: The legislature needs to consider whether an investment in economic development is a high priority. If successful, the investment could be a partial solution to the current budget crisis by providing more stimulus for economic recovery. It is also important to assess the effectiveness and whether these investments are producing cost benefits.

**Fiscal
Challenge**

Potential loss of federal funds can occur in any instance where the state is forced to make budget cutbacks, especially when a significant share of general fund dollars are used as a match for federal funds. The loss of federal funds translates to reductions in services to citizens, loss of jobs in the state, and loss of "imported" money into the Montana economy.

Executive Proposal: The Executive Budget includes \$23.2 million in general fund reductions that result in federal fund reductions of \$45.5 million for the biennium. Most of these impacts occur in the Department of Public Health and Human Services.

Issue: The legislature needs to consider the impact of reduced federal matched funds when prioritizing budget options in resolving the current deficit.

**Fiscal
Challenge**

Supplemental emergency appropriations for the next biennium are not budgeted for by the legislature and not accounted for in the ending fund balance. The state continues to experience supplemental appropriations each biennium, particularly for fire suppression.

Executive Proposal: The 2005 biennium executive budget does not include an amount set aside for supplemental appropriations in anticipation of “potential” expenditures, although it does call for a significant increase in the emergency appropriation, from \$12 million to \$25 million. This appropriation is not included in their projected ending fund balance.

Issue: The state has historically experienced some chronic emergency costs and caseload induced cost overruns. For example, the state has experienced perennial fire costs, ranging from \$0.8 million to \$39.4 million over the last 11 biennia, and averaging nearly \$10 million per biennium when the highest and lowest are excluded. Even though fires are not predictable events, it would be prudent to reserve funds to cover such reoccurring items. At a minimum, the legislature should consider the potential for future supplemental appropriations when determining an appropriate ending fund balance.

**Fiscal
Challenge**

Pending litigation can impact state finances. Currently, there are two legal actions pending that seek changes and increased funding for services for the developmentally disabled: the Montana Advocacy Program (MAP) Travis D. class action lawsuit, and the Montana Association for Independent Disability Services, Inc. (MAIDS) lawsuit. There is also a lawsuit challenging adequacy of state funding for schools.

Executive Proposal: The executive proposes increased funding for developmental disabilities programs by \$7.7 million general fund and about \$18.4 million total funds, and uses general fund monies made available due to “refinancing” efforts to strengthen and expand services.

Issue: A conservative estimate of the potential additional costs of services for developmentally disabled individuals if the state is not successful in defending against these legal actions is \$20 million.

Executive Proposal: The executive proposes to hold state support to schools at fiscal 2002 levels over the 2005 biennium.

Issue: In September 2002, a suit was filed in Montana’s first judicial district court against the state of Montana alleging that the state has not adequately funded its K-12 school system. The suit will be heard sometime after the first of the year in calendar 2004. State support for school district costs as a percent of total district funding is very likely to decline further under the executive budget proposal.

What Other Fiscal Issues are important to consider?



OTHER FISCAL ISSUES

INTRODUCTION TO OTHER FISCAL ISSUES

The Legislative Fiscal Division analysis also includes several fiscal issues not directly related to the Executive Budget, but that will potentially have an impact on the budget passed by the legislature and/or the budget process. These fiscal issues are varied and sometimes complex. It is important that the legislature be aware of them in its deliberations. The following briefly describes each issue. These issues are described in more detail later in this volume under the title, "Other Fiscal Issues to Consider." Page references are provided for each issue.

- **Tobacco Settlement Funds.** Montana receives revenue as a settling party to a Master Settlement Agreement. Of \$57.2 million expected in the 2005 biennium, 40 percent is earmarked for the Tobacco Trust, 32 percent funds tobacco prevention programs, and 17 percent funds the Children's Health Insurance Program. The remaining 11 percent is to be deposited in the general fund. Anticipated interest earnings of \$5.7 million from the trust must be allocated 10 percent to the trust and 90 percent as appropriations for disease prevention and programs providing benefits, services, or coverage related to the health care needs of Montana citizens (Page 125)
- **District Court Assumption.** Under SB 176, the district courts, with the primary exception of the clerks of court and the provision of office space, became a state-funded function. Beginning in fiscal 2003, the state Judiciary assumed responsibility for oversight and administration of the 22 courts, including approximately 245 additional FTE. Implementation was accomplished through the efforts of the District Court Council, provided in SB 176 (2001 regular session), along with Judiciary staff. During this time and since implementation, the council and branch have encountered issues with SB 176 and continue to advocate that the bill was under-funded. The executive recommends \$37.3 million for the 2005 biennium budget for district courts administration. (Page 126)
- **Statutory Appropriations.** Expenditures from statutory appropriations in the 2005 biennium are estimated at \$268.1 million, an amount significantly higher than for biennia prior to passage of HB 124 in 2001. Entitlement payments to local government account for \$167.2 million. These appropriations become a greater concern, as the amount of money appropriated does not automatically get reviewed by the legislature. (Page 129)
- **General Fund Transfers.** Transfers of \$1.8 million from the general fund to other funds in the 2005 biennium, are markedly higher than in biennia that preceded HB 124, enacted in 2001. Like statutory appropriations, these transfers and their authorizations are in statute and are not part of the biennial budgeting process, meaning that the monies are not part of the budget prioritization process to the same extent as other general fund monies. (Page 132)

- **General Fund – Cash Position.** The projected general fund ending cash position for fiscal 2003 is at a historical low point. The importance of the cash position is significant and sufficient cash is required to pay the state's budgeted obligations. At this time the general fund ending balance for fiscal 2003 is estimated at \$4.4 million. Of that balance, there is an approximate \$5.0 million differential between the ending fund balance and the cash balance of the general fund. This suggests that at the end of fiscal 2003, the general fund may have a negative \$0.6 million ending cash balance. (Page 134)
- **Local Government Assistance Restructuring.** Beginning in fiscal 2002, HB 124 reallocated revenue to the state that had formerly gone to local jurisdictions. The local revenue was replaced by creating entitlements for counties and cities. Entitlements for counties, cities and consolidated governments will be \$7.5 million higher in the 2005 biennium than in the 2003 biennium. These rates of growth exceed the expected rate of growth in state revenues for the 2005 biennium. (Page 136)
- **Mental Health Services: Interim Study.** A subcommittee of the Legislative Finance Committee (LFC) focused on the commitment process to the Montana State Hospital and to community services, and transitions to intensive services in the community. The LFC recommended five pieces of legislation. (Page 138)
- **Fund Balance Adequacy/Reserves.** Ensuring that there are sufficient revenues to fund state programs is one of the responsibilities of the legislature. The legislature's challenge is to ensure that there is an adequate fund balance reserve to protect the state spending plan from unexpected events. (Page 140)
- **Accruals.** Agencies booked general fund accruals totaling \$18.3 million in fiscal 2002, which are part of the 2002 biennium base. The LFD questions \$240,000 of these accruals and whether they can be removed from the budget. (Page 142)
- **Unified Computer Budget.** The Executive Budget for the 2003 biennium was the first budget to include a "unified computer budget" as specified in HB 2 of the 1999 session. Actual fiscal 2000 information technology (IT) expenditures were \$77.9 million, or 10.1 percent of HB 2 operating expenditures. (Page 143)
- **Other Major Funds.**
 - *Highway Special Revenue Account.* The 2003 legislature is faced with a declining working capital balance in the highways state special revenue account. The account is projected to end fiscal 2005 with a working capital balance of \$10.2 million, which is down from a \$51.4 million balance at the end of fiscal 2002. Projections indicate that expenditures will exceed revenues by \$21.0 million in the 2005 biennium, with the imbalance continuing in future biennia. (Page 146)

- *Resource Indemnity Trust.* During fiscal 2002, the Resource Indemnity Trust (RIT) exceeded the \$100 million threshold. This will result in a redistribution of money that would otherwise have gone into the trust. In addition, of seven accounts that have historically received allocations of Resource Indemnity and Ground Water Assessment Taxes or Resource Indemnity Trust interest earnings, four are projected to have negative balances by the end of the 2005 biennium. The legislature will need to address the distributions of RIT funding streams to insure a balance between revenues and disbursements. (Page 146)

Where did we go wrong?

Is the budget crisis unique to Montana?



WE'RE NOT ALONE – OTHER STATES' BUDGET WOES

BUDGET SHORTFALLS

The decade of the nineties was a period of unprecedented economic growth in the United States, and state governments benefited from excellent fiscal conditions, where revenues generally grew above expectations while spending pressures declined for many large programs such as human services and education.

Now, however, nearly all states face a huge fiscal crisis. Revenues have dropped off dramatically, and total state tax revenue in fiscal 2002 was nearly \$40 billion lower than in previous years (adjusted for inflation). Revenues in the nineties grew above expectations due to higher levels of economic activity and unprecedented capital gains realizations. While Montana did not really feel the effects of a recession, capital gains had a huge impact. The revenue growth of the nineties turned out to be temporary, and likely unsustainable. Further, most states reduced revenue levels through tax cuts while building a higher expenditure base. The expectation in 2003 nationwide is to barely hold steady at the reduced revenue levels of 2002, and for only a slow, modest recovery beyond 2003. There is little optimism for a full return to pre-2001 revenue levels, and spending pressures from Medicaid and other health care costs are growing faster than in the nineties. The current crisis is seen as the worst state budget situation in over a half-century.

The revenue downturn has and will have a substantial impact on the level of government services. To date, nearly all states have avoided either major service reductions or tax increases by finding short-term solutions, budget transfers, and other “easy” solutions. But states are running out of options, and most 2003 legislatures will face severe deficits that require either significant tax increases, program/service reductions, or a combination of both. Revenue estimates reflect a resignation that the state revenues will not bounce back soon.

Comparatively, Montana's budget shortfall is slightly below the average for all states. In 2002, the states with the largest deficits were Alaska (a 20 percent shortfall), California, Arizona, Nevada, Oregon, Colorado, and neighboring Idaho. In the past two years, 47 states have had to deal with general fund shortfalls. Wyoming is one of the fortunate to have avoided the crisis.

SOLUTIONS

As stated previously, states have tweaked their budgets and found short-term fixes, hoping to avoid the inevitable. In fiscal 2002, all states avoided significant tax increases or program reductions. In fiscal 2003, states began reluctantly turning to tax increases and program reductions. Over the past two years, the most common solutions states have used to date include:

- Well over half the states have tapped their rainy day funds to fill the budget gaps -- A total of 46 states have rainy day fund provisions
- Nearly all states have implemented program reductions
 - Over half the states approved across-the board percentage budget reductions
 - Most states have implemented health care reductions, including Medicaid growth control (benefits and eligibility), provider payment reductions, and drug costs
 - Over half the states have had some state employee lay-offs, and at least five have enacted early retirement incentives
- 16 states implemented minor tax enhancements in fiscal 2002, while 24 have implemented tax increases in fiscal 2003 - this is a reversal of nearly a decade of tax reductions by states on average
 - 15 states increased cigarette taxes in fiscal 2002 and another 19 did so in fiscal 2003, by an average of nearly 50 cents per pack
 - 17 states increased sales taxes, 17 increased personal income taxes, and another 15 states increased corporate income taxes
 - Vehicle, motor fuel, and gaming taxes were changed by several states
 - Six states have implemented tax amnesty periods
- Nearly half the states have implemented fee increases on such items as driver's licenses, car registration, and gaming
- At least 14 states have sold part or all of their tobacco settlement future revenue streams for a one-time revenue source
- Most states have assessed local government a share of the budget cutbacks
- Other measures
 - Delay of building projects
 - Borrowing from other funds
 - Gaming expansion
 - Shifting of funds to federal or state special revenue

GENERAL FUND OUTLOOK

LFD Perspective



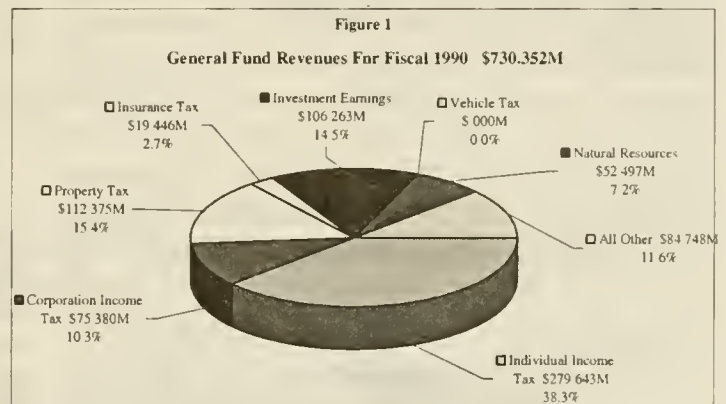


STATE FINANCES - HISTORICAL PERSPECTIVE

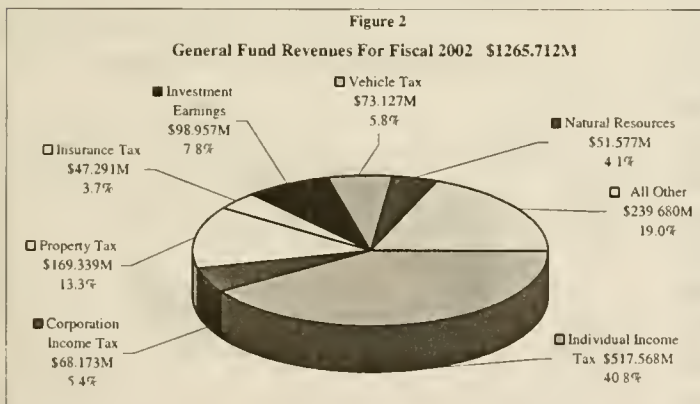
REVENUE HISTORY

The recent history of finances in the state of Montana has followed an upward trend. On both the revenue and expenditure side, Montana state finances have increased significantly.

From fiscal 1990 through fiscal 2002, the relative importance of the revenue components has changed only slightly. In fiscal 1990 as now, the largest component of general fund revenue was collections from individual income tax. As shown in Figure 1, individual income tax made up 38.3 percent of total general fund revenues. Property tax collections were next, with collections amounting to 15.4 percent of all general fund revenues. Investment earnings follow, adding 14.5 percent of the collections to the revenue base.



In fiscal 2002, individual income tax collections increased slightly in terms of its relative importance to the general fund, now making up 40.8 percent of total general fund collections. Property tax collections are only 13.3 percent of general fund collections, while investment earnings fell in relative importance to only 7.8 percent of total revenues. Total general fund revenues are shown in Figure 2.



Over the 13-year period spanning from fiscal 1990 through fiscal 2002, revenues have increased substantially. General fund revenues during the period have increased by over \$535.3 million, from \$730.4 million in fiscal 1990 to \$1,265.7 million in fiscal 2002. This represents an increase of more than 73.3 percent in nominal terms. In real terms, when adjusted for inflation, the change is over 33.0 percent. This rate of growth is significant and can be traced almost exclusively to the increases in individual income tax and property tax collections.

Over the same period, individual income tax has increased by 34.9 percent, and property tax has increased by 10.4 percent in real terms. Figure 3 depicts the cumulative increases of general fund revenues in both dollar and percent terms for the 13-year period.

EXPENDITURE HISTORY

General fund expenditures have also increased substantially since fiscal 1990. A portion of the increase is attributable to increased state spending due to inflationary pressures. Further increases can be explained by growth in human service caseloads, prison population, and average number belonging (ANB) increases.

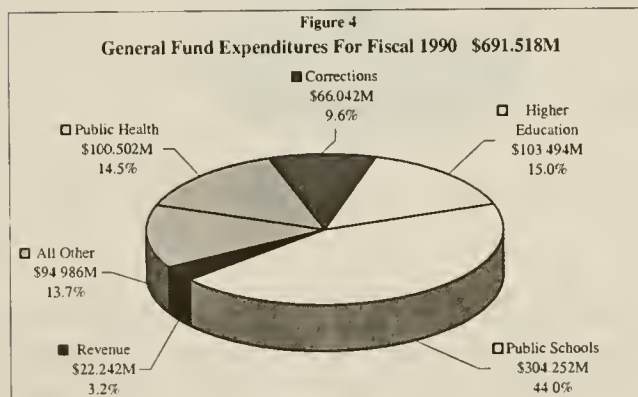
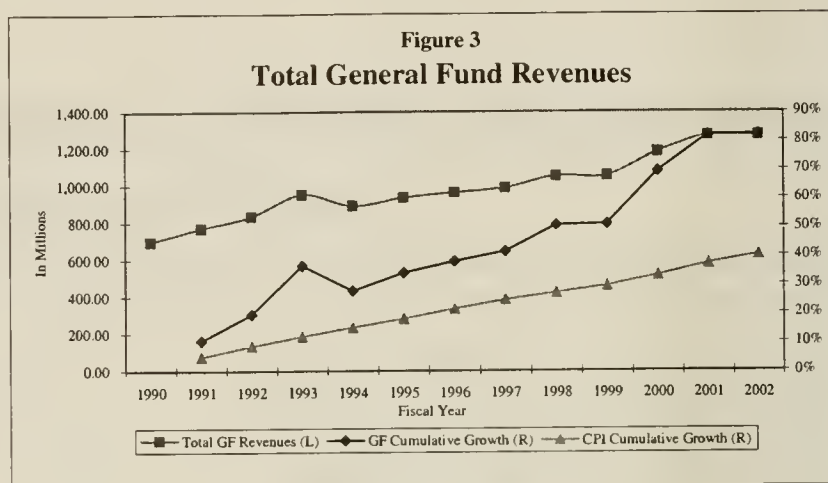
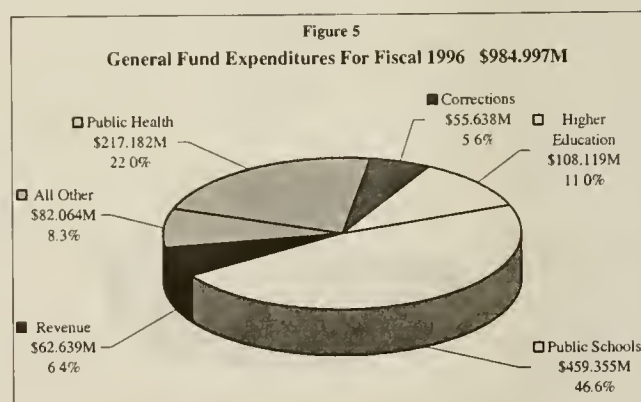
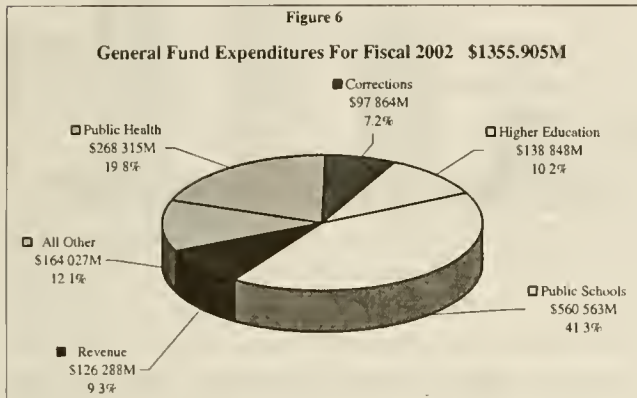


Figure 4 shows the general fund expenditure components for fiscal 1990, along with the dollars expended and the percent of total general fund spending. In all years, expenditures for public schools are the greatest portion of total general fund expenditures, consuming 44.0 percent of general fund dollars. In fiscal 1990, expenditures for higher education were the second highest area, utilizing 15.0 percent of general fund revenues. At that time, Public Health expenditures were only 14.5 percent of total general fund spending.

In fiscal 1996, the legislature reorganized public health entities, which moved health service related functions into one agency. Consequently, general fund expenditures for public health accounted for 22.0 percent of total general fund expenditures. The expenditures for higher education increased in the period between fiscal 1990 and fiscal 1996 by 4.5 percent and dropped to the third highest area in general fund terms. Public school funding was also increased in fiscal 1996. Consequently, general fund support for schools increased by 51.0 percent and account for 46.6 percent of total general fund expenditures. Figure 5 shows the fiscal 1996 general fund expenditures.



By fiscal 2002, public school support dropped in relative weight to the general fund support. As seen in Figure 6, public schools consumed 41.3 percent of available general fund dollars. Public health, the second largest consumer, expended 19.8 percent of the total general fund. Higher education share of general fund expenditures by fiscal 2002 dropped to 10.2 percent of the total.

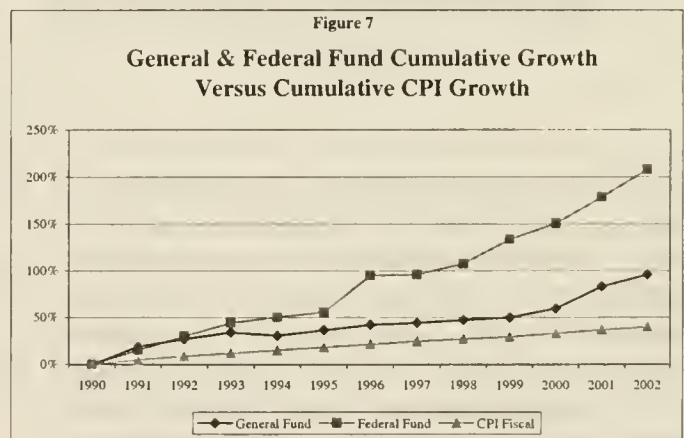


During the 6-year period between fiscal 1996 and fiscal 2002, total general fund expenditures have increased from \$985.0 million to \$1,355.9 million. This corresponds to a nominal increase of 37.7 percent but an increase in real terms of 19.0 percent. The greatest portion of this increase is seen in the three program area, public schools, public health, and higher education. Since fiscal 1996, public school expenditures have increased from \$459.4 million to \$560.6 million, an increase of 11.9 percent in real terms. Public health expenditures have increased from \$217.2 million to \$268.3 million, increasing over 4.8 percent in

real terms. Higher education has experienced increases from \$108.1 million to \$138.8 million in the six years. This represents a 9.7 percent increase in real terms.

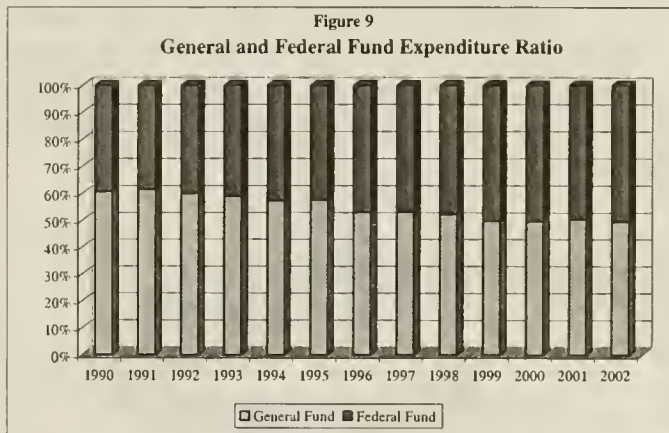
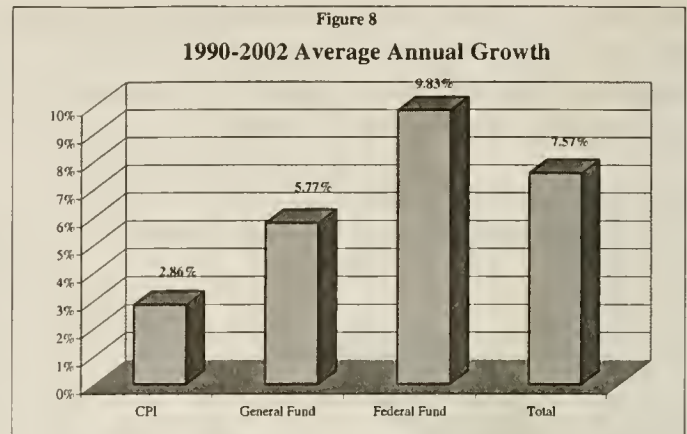
FEDERAL FUND EXPENDITURES

While general fund expenditures have increased cumulatively over 42.0 percent in real terms since fiscal 1990, federal funds have increased by 167.8 percent. Montana has become substantially more dependent upon federal funds to support its expenditures, as illustrated in Figure 7.



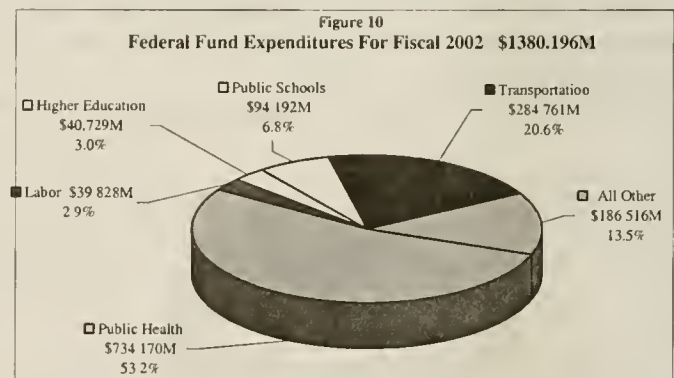
Annual growth for the general fund has been 5.8 percent in nominal terms over the 13-year period. Nominal annual growth in federal funds is 9.8 percent. The average annual nominal growth for both fund sources is 7.6 percent, or 4.7 percent when adjusted for inflation, as shown in Figure 8.

In Figure 9, the ratio of general fund to federal fund has changed significantly since fiscal 1990. Where federal funds paid for approximately 39.3 percent of state expenditures in fiscal 1990, they now support over half.



The largest area of federal support goes to public health expenditures. In fiscal 2002, Montana received over \$734.2 million in federal aid for public health programs. This corresponds to 53.2 percent of the federal funds received. Transportation received \$284.7 million in federal aid or 20.6 percent of all federal funds, and public schools received \$94.2 million or another 6.8 percent of the federal funds provided to Montana. Figure 10 presents the entire breakout of federal fund expenditures for fiscal 2002.

General fund revenues and expenditures and federal funds have all increased since fiscal 1990. Typically, the increases have surpassed inflation. The state has directed the increased revenues to all budgets, but the greatest increases, in dollar terms, have been expended in the largest budgets, public schools, public health, and higher education. Finally, Montana has grown increasingly dependent on federal funds to support these programs.



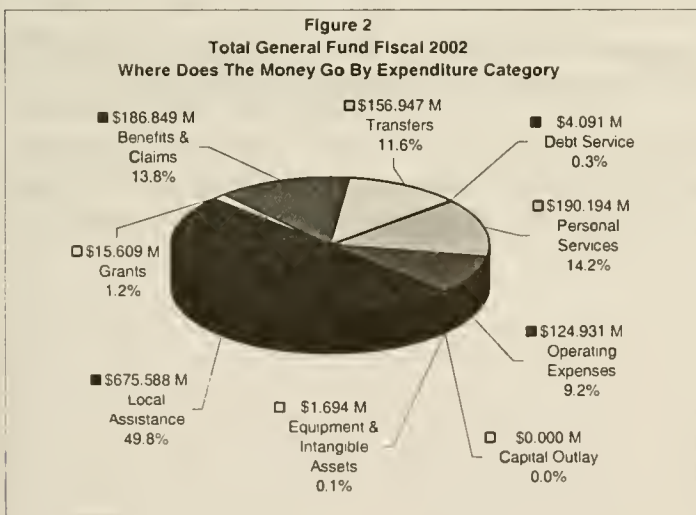
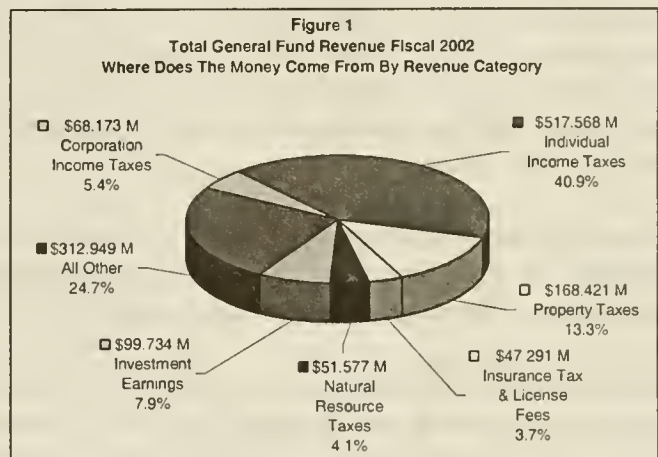


GENERAL FUND ANALYSIS

INTRODUCTION

The state general fund is the primary account that funds a significant portion of the general operations of state government and is often referred to as the state's checking account. This account has grown from slightly less than \$700 million in fiscal 1990 to over \$1.3 billion in fiscal 2002, or approximately 5.8 percent annually. Figure 1 shows where the money in this account comes from by major revenue category, while Figure 2 shows how the money is expended by major expenditure category. The information shown in both figures represents actual data for fiscal 2002.

In fiscal 2002, almost 60 percent of total general fund revenues came from income and property taxes. Total revenues to the account for the 2005 biennium are estimated to exceed \$2.5 billion, which is an increase of \$52.7 million, or 2.1 percent from the 2003 biennium. House Bill 7, enacted during the August special legislative session, created a new state special guarantee account, which receives deposits of interest and income, timber, and mineral royalty revenues from school lands. These monies were previously



deposited in a sub-account within the general fund. This means that revenues for the 2003 biennium include school land revenue for fiscal 2002 that have been removed for fiscal 2003. If the fiscal 2002 amount is adjusted to exclude this revenue, the adjusted general fund growth rate is projected to be 4.2 percent from the 2003 to 2005 biennium.

Interestingly, about 23.4 percent of the general fund revenue is expended for personal services and operating costs with most of the remainder disbursed for local assistance, human service benefits, and grants. This indicates that the cost

of government is weighted heavily towards local assistance (local government entities including public schools) and direct human service benefits. Total general fund disbursements represent approximately 38 percent of all state expenditures in the general, state special, federal special, and selected proprietary fund types.

Balancing general fund appropriations against anticipated revenues is a major challenge of each legislative session and requires a significant coordination between the taxation and appropriation committees. Based on revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC) on November 19, 2002, there are insufficient revenues to support the executive present law budget recommendations, leaving an ending fund balance of a negative \$232.0 million.

There are insufficient revenues to accommodate all of the executive new proposals including the executive's recommended ending fund reserve of \$50.1 million. If the total Executive Budget were funded as requested, the ending balance in the general fund would be \$36.6 million. One of the reasons for this reduced balance is that the projected balance uses the final revenue estimate recommendations of the RTIC. The Executive Budget was based on higher revenue estimates developed by the executive's staff. The result is that the balanced budget as submitted by the executive does not achieve the recommended \$50.1 million reserve when using RTIC general fund revenue estimates.

This section of the budget analysis provides a summary of the general fund account as projected through the 2003 biennium. It begins with a reconciliation of the current (2003 biennium) projected fund balance in order to arrive at the beginning balance for the 2005 biennium.

This section is followed by a summary of the 2005 biennium economic assumptions and associated revenue estimates as adopted by RTIC, including a graphic view of the significant revenue components. Additionally, a summary of the projected present law general fund balance using RTIC revenue estimates is shown. A projected general fund balance is also shown when the executive new proposals are included.

Finally, the differences between the executive proposed fund balance and the balance using RTIC revenue estimates and LFD statutory disbursement and reversion computations are explained.

2003 BIENNIUM GENERAL FUND PROJECTION

After completion of the Fifty-seventh Legislature, the unreserved ending general fund balance for the 2003 biennium was projected to be \$53.8 million (Figure 3). This balance was based on: 1) revenue estimates adopted in HJR 2; 2) LFD statutory appropriation and reversion estimates; 3) all general fund appropriations authorized by the legislature; and 4) the estimated impacts of all enacted revenue legislation. The Fifty-seventh Legislature did not budget for any supplemental or emergency appropriations.

Figure 3 also shows the projected ending general fund balance for the 2003 biennium after completion of the August 2002 special legislative session. The legislature was called into special session by the Governor when the executive determined that the spending

reductions authorized under 17-7-140, MCA would not be sufficient to maintain a general fund balance equal to one percent of all general fund appropriations. The August Special Session legislature adjourned with a projected balance of \$27.2 million.

Figure 3 Comparison of 2003 Biennium General Fund Balance Post Regular Session Budget vs. Post Special Session Budget In Millions			
	Regular Session 2003 Biennium	Special Session 2003 Biennium	Difference 2003 Biennium
Beginning Fund Balance	\$110.729	\$172.897	\$62.168
Revenues			
Current Law Revenue	2,677.566	2,494.059	(183.507)
Total Funds Available	\$2,788.295	\$2,666.956	(\$121.339)
Disbursements			
General Appropriations	2,274.123	2,181.256	(92.867)
Statutory Appropriations	92.195	278.558	186.363
Local Assistance Appropriations	326.739		(326.739)
Miscellaneous Appropriations	8.483	157.593	149.110
Non-Budgeted Transfers	31.930	30.133	(1.797)
Continuing Appropriations		9.262	9.262
Supplemental Appropriations			
Feed Bill Appropriations		0.498	0.498
Executive Reductions		(16.148)	(16.148)
Legislative Reductions		(0.350)	(0.350)
Anticipated Reversions	(6.027)	(14.941)	(8.914)
Total Disbursements	\$2,727.443	\$2,625.861	(\$101.582)
Adjustments		(1.163)	(1.163)
Reserved Ending Fund Balance	\$60.852	\$39.932	(\$20.920)
2003 Session Feed Bill Reserve	7.028	7.200	0.172
2003 Session Supplemental Reserve		5.580	5.580
Unreserved Ending Fund Balance	\$53.824	\$27.152	(\$26.672)
Net Operations	(\$56.905)	(\$144.582)	(\$87.677)

As Figure 4 shows, the revised unreserved general fund balance at the end of the 2003 biennium is now projected to be \$4.4 million. This revised projection is based on: 1) revenue estimates adopted by RTIC on November 19, 2002; 2) LFD statutory appropriation and reversion estimates; and 3) supplemental appropriation recommendations by the executive. This projected balance equals 0.27 percent of anticipated revenues for the 2003 biennium and is \$22.8 million below the balance anticipated during the August 2002 special legislative session.

Figure 4 Comparison of 2003 Biennium General Fund Balance Post Special Session Budget vs. LFD Budget Analysis In Millions			
	Special Session 2003 Biennium	Budget Analysis 2003 Biennium	Difference 2003 Biennium
Beginning Fund Balance	\$172.897	\$172.897	
Revenues			
Current Law Revenue	2,494.059	2,474.121	(19.938)
Total Funds Available	\$2,666.956	\$2,647.018	(\$19.938)
Disbursements			
General Appropriations	2,181.256	2,179.145	(2.111)
Statutory Appropriations	278.558	275.058	(3.500)
Local Assistance Appropriations			
Miscellaneous Appropriations	157.593	152.511	(5.082)
Non-Budgeted Transfers	30.133	27.812	(2.321)
Continuing Appropriations	9.262	8.026	(1.236)
Supplemental Appropriations		15.686	15.686
Feed Bill Appropriations	0.498	8.622	8.124
Executive Reductions	(16.148)		16.148
Legislative Reductions	(0.350)		0.350
Anticipated Reversions	(14.941)	(23.678)	(8.737)
Total Disbursements	\$2,625.861	\$2,643.182	\$17.321
Adjustments	(1.163)	0.521	1.684
Projected Ending Fund Balance	\$39.932	\$4.357	(\$35.575)
2003 Session Feed Bill Reserve	7.200		(7.200)
2003 Session Supplemental Reserve	5.580		(5.580)
Unreserved Ending Fund Balance	<u>\$27.152</u>	<u>\$4.357</u>	<u>(\$22.795)</u>

The decrease in the projected general fund balance is due to several factors that have transpired since the adjournment of the August special session. Total general fund revenues are expected to be \$19.9 million less than anticipated, while disbursements are expected to be \$3.9 million more than authorized by the regular and special session legislatures. Fund balance adjustments that increase the fund balance are expected to be \$1.7 million more than anticipated.

The decreased revenue condition (\$19.1 million) can be attributed to the factors shown in Figure 5. As shown in Figure 5, most of the revenue adjustments were due to new data becoming available that was not available during the August special legislative session. For example, individual income tax returns for calendar year 2001 became available on November 1. Prior to this time, revenue estimates were developed using calendar 2000 tax return information.

The primary reasons for the increased disbursements (\$3.9 million) are: 1) increased supplemental

Figure 5
Significant General Fund Adjustments For 2003 Biennium
Special Session vs. Budget Analysis
In Millions

General Fund Component	2003 Biennium Adjustment	Explanation
Revenue Adjustments	(\$19.938)	
Individual Income Tax	(4.220)	More Current Data
Corporation Income Tax	(9.281)	More Current Data
Treasury Cash Account Interest	(5.138)	Reduced Interest Rates
All Other Revenue	(1.299)	Various Reasons
Expenditure Adjustments	4.541	
Additional Supplementals	10.100	DPHHS/OPI/DNRC
Other Appropriation Adjustments	(5.559)	Statutory/Transfers/Miscellaneous
Fund Balance Adjustments	1.684	Fiscal Year End 2002 Adjustments
Total	(\$22.795)	

appropriations of \$10.1 million (see page 91, for more details) and 2) reduced miscellaneous and statutory appropriations and transfers of \$5.6 million (see page 129 for more details). As Figure 5 shows, the combined impact of lower revenues, greater disbursements, and a positive fund balance adjustment is a net decrease in the projected fund balance of \$22.8 million for the 2003 biennium.

2005 BIENNIUM GENERAL FUND OUTLOOK

INTRODUCTION

This upcoming legislative session is probably the most difficult budget situation the state has faced in a number of years. Not only are anticipated revenues significantly below the level of funding needed to fund "present law" services, the projected ending fund balance for the current biennium is below the statutory minimum as defined in 17-7-140, MCA. Because this balance is so low, the legislature will not be able to use previous excess fund balances to help balance the 2005 biennium budget.

In addition, the current economic uncertainty facing the national as well as world economies is significant. A sluggish national economy combined with the continued threat of terrorism attacks and a potential U.S. war with Iraq makes the job of developing prudent revenue estimates an extremely difficult task. Artificially low estimates may cause the legislature to reduce state services that fall below the legislature's priority line. Estimates that are too high may create the temptation for the legislature to fund state services that the state cannot afford. Obviously, the last scenario would result in spending reductions by the executive and/or a special session.

As delineated in Section 5-18-107(1) (a), MCA, the Revenue and Transportation Interim Committee (RTIC) is required to prepare "an estimate of the amount of revenue projected to be available for legislative appropriation." In addition, sections 5-12-302(2) and 5-12-307(7) specifically require the Legislative Fiscal Analyst (LFA) to "estimate revenue from existing and proposed taxes" and also requires the LFA to "assist the revenue and transportation committee in performing its revenue estimating duties..."

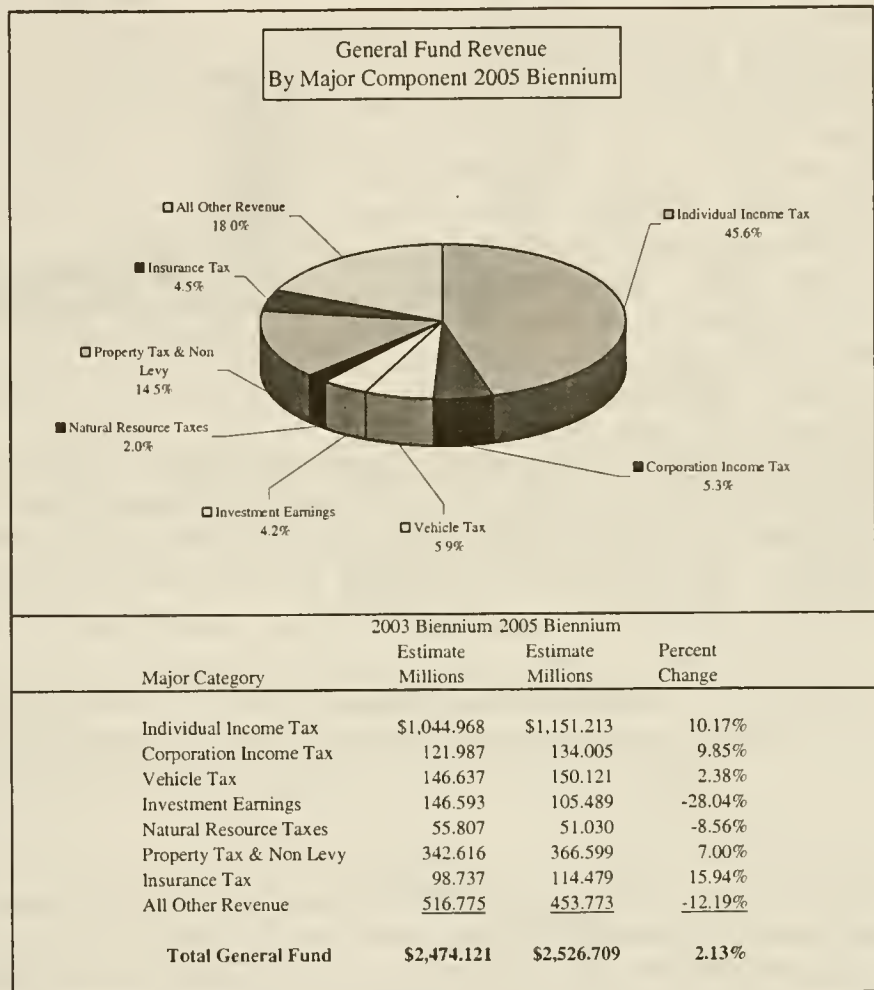
The next section of the report highlights the significant economic assumptions used by the RTIC to develop the revenue estimate recommendations contained in HJR 2, the revenue estimate resolution. Each assumption is discussed and is graphically portrayed to give the reader a perspective of the historical trend versus the forecast amount.

GENERAL FUND REVENUE IMPLICATIONS

Montana's fiscal outlook for revenue growth is less optimistic than in previous biennia. The key economic assumptions targeted as most affecting state government receipts are Montana total income, employment or population levels, inflation rates, corporate profits, property values, interest rates, and energy prices.

As shown in the figure at the right, individual income tax, corporation income tax, property tax, vehicle tax, and investment earnings are expected to contribute over 75 percent to the total general fund revenue stream during the 2005 biennium. Total general fund revenues for the 2005 biennium are projected to increase 2.1 percent over the 2003 biennium projections. The comparative change by major revenue category is shown at the bottom of the figure. House Bill 7,

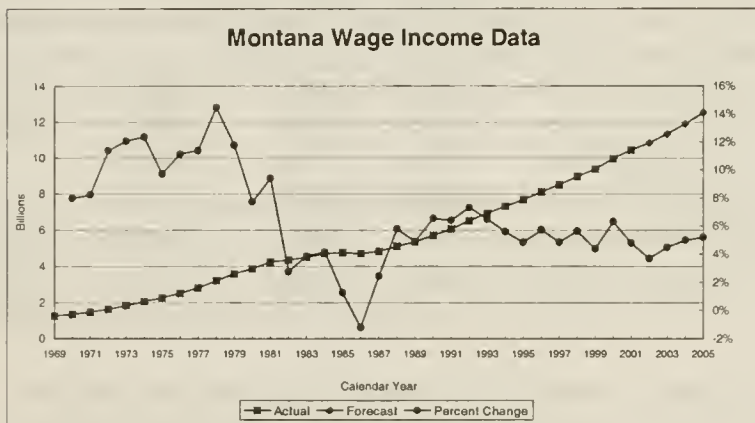
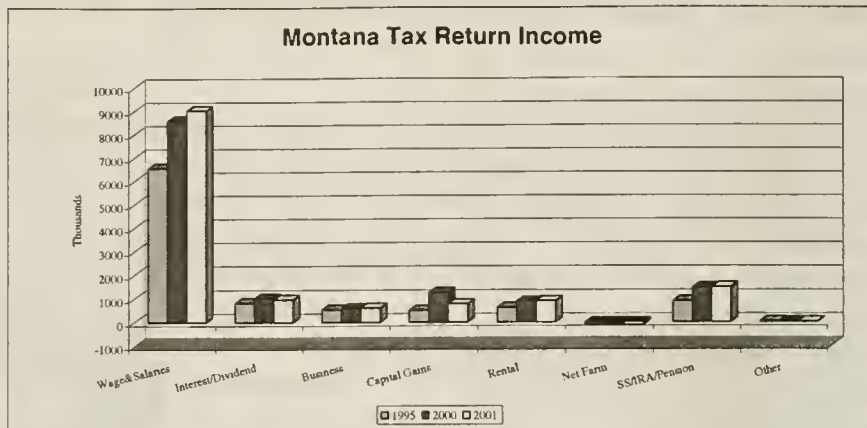
enacted during the August special legislative session, created a new state special guarantee account, which receives deposits of interest and income, timber, and mineral royalty revenues from school lands. These monies were previously deposited in a sub-account within the general fund. This means that revenues for the 2003 biennium include school land revenue for fiscal 2002 that has been removed for fiscal 2003. If the fiscal 2002 amount is adjusted to exclude this revenue, the adjusted general fund growth rate is projected to be 4.2 percent from the 2003 to 2005 biennium.



Montana Total Income

The total of all income sources listed on the Montana personal income tax form is referred to as Montana total income. The Department of Revenue tracks income from 11 different components, including wages, interest, dividends, business, capital gains, supplemental, rental, farm, social security, IRA and pension, and other incomes. Montana total income is the single most important

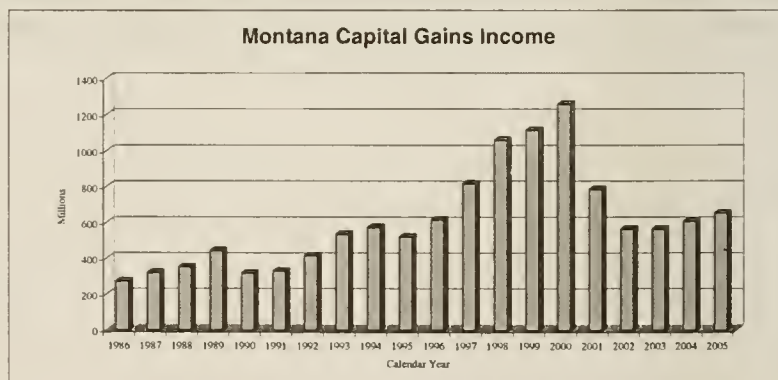
variable to consider in the revenue estimation process. Of the 11 income items, wage and salary income provides the largest portion of Montana total income. Since 1990, wage and salary income has contributed an annual average of 65.2 percent of total income. In calendar 2001, it contributed 65.8 percent, or \$9.013 billion. The average annual growth from calendar 1990 to 2001 has been 5.5 percent.



In recent times, capital gains income has been the focus of much conversation and speculation. Capital gains income has increased in relative importance over the decade. In 1990, capital gains made up only 4.2 percent of total income, with reported income of \$318 million. In 2000, capital gains contributed 9.2 percent of total income, at \$1.260 billion. In 2001, capital gains receded to 5.7 percent of total income, with income at \$786 million. That equates to a reduction of over 37.6

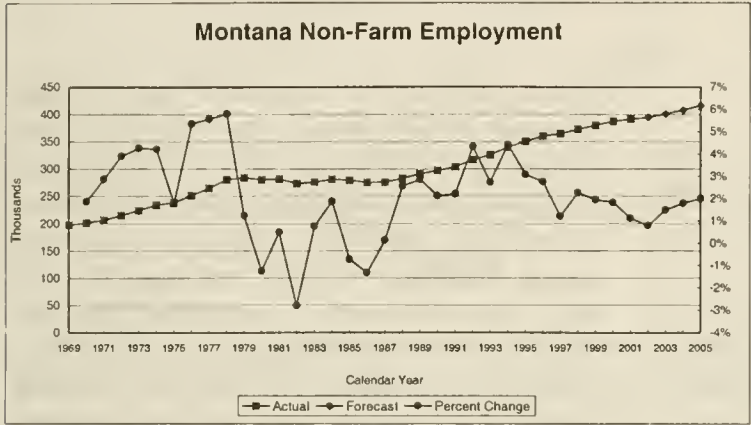
percent over the previous year, or \$474 million in income.

For the 2005 biennium, growth in wages and salaries is expected to be slow in calendar 2002 and 2003, while gradually increasing to about 5 percent by calendar 2005. Capital gains is projected to decline an additional 28 percent in calendar 2002 and remain flat in calendar 2003. For the last two years of the forecast period, capital gains are estimated to rebound to a historic growth rate of 7.5 percent per year.



Montana Employment

Like personal income, employment plays a key role in shaping the estimate of the individual income tax revenues. Furthermore, the information allows a view into the changing employment climate in Montana, where jobs are migrating, and how incomes might be altered. Dr. Paul Polzin, Director of the



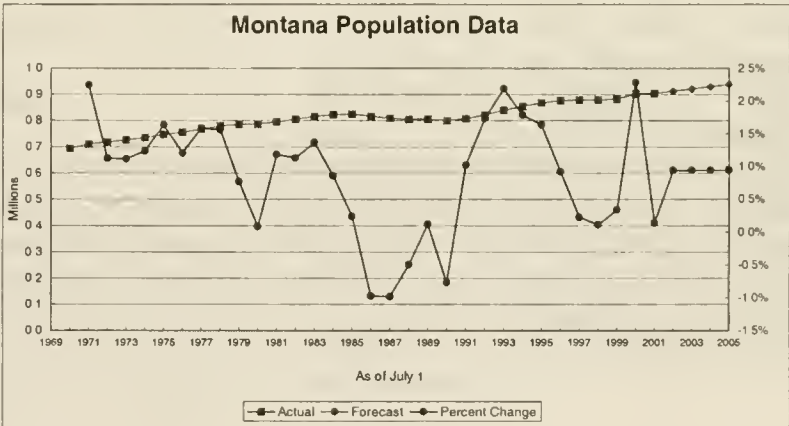
Montana Bureau of Business and Economic Research, is one of the several sources that provide information concerning the changing industrial make up of the state. Specific detailed data is gathered from the Montana Department of Labor, Research and Analysis Division. The statistics collected include employment in manufacturing, mining, construction, public utilities, wholesale and retail, finance, insurance, real estate, services, and government sectors. Average annual growth since 1996 has

been 2.0 percent. The estimates for future growth, during the forecast period, reflects a gradual increase of 0.8 percent in calendar 2002 to 1.8 percent by calendar 2005. Over the past decade, the largest area of growth was seen in construction employment, which experienced 98.1 percent positive growth. The service sectors follow, experiencing 55.4 percent growth in the same period. Mining is the only area that saw negative growth, with a workforce reduction of 12.7 percent since 1990.

Montana Population

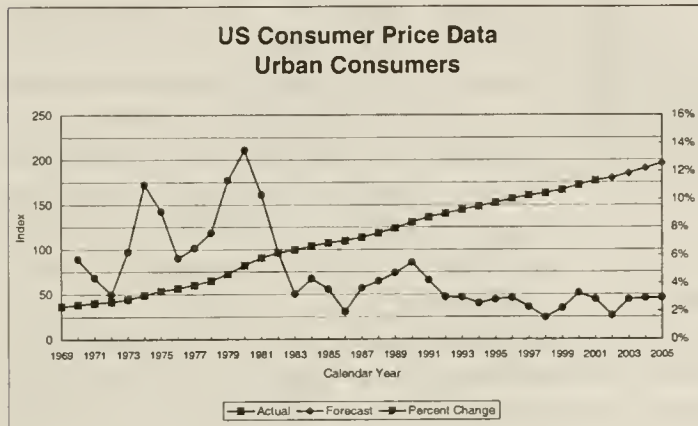
Population statistics are used to develop estimates for many of the revenue sources including beer, wine, liquor, and cigarette taxes. In addition to those sources where population has a direct effect, the size of the population indirectly affects the profitability of all businesses and the employment levels statewide. Accurate population estimates are especially important when determining the changes expected in overall and per capita income for the state.

Consumption of any given item is highly reliant upon the size of the population, so accurate population forecasts are essential when determining tax revenues from the sources mentioned above. Historic population data is gathered from the U.S. Census department while projections are obtained from Woods and Poole Econometric Service. Since the early 1990's, Montana has experienced positive growth in total population varying between 0.1 percent in 1998 to 2.3 percent in 2000. Growth through the next biennium is estimated at 0.9 percent annually.



Inflation Rates

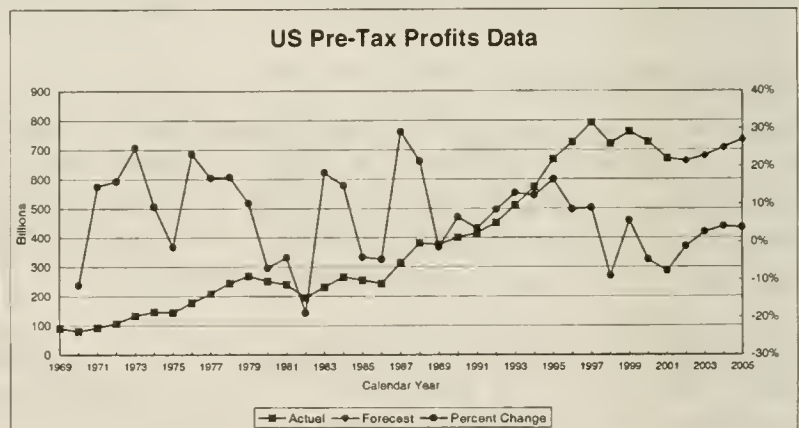
The inflation rate is measured by the price change of the Consumer Price Index (CPI) "shopping basket" of goods and services. Inflation is noted to have both good and bad effects. As prices rise, businesses increase prices and tend to become more profitable. At the same time, the consumer realizes a reduction in disposable income and spends less. Several areas where this information is vital in determining costs include minerals, timber, energy resources, and most services.



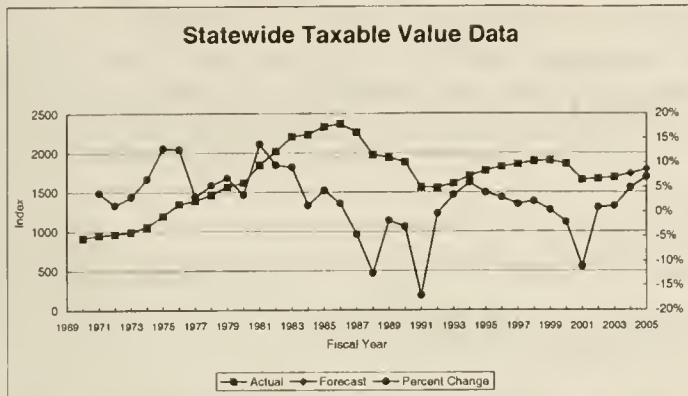
Since Montana's individual income tax structure is fully indexed by changes in the consumer price index, this assumption is critical in the formulation of the individual income tax forecasts. The U.S. Bureau of Labor Statistics provides the required CPI data for the all-urban customers data set. Since 1990, the average annual rate of inflation has been 3.0 percent. Global Insight Co. (formerly DRI-WEFA) estimates inflation during the next biennium at an average annual rate of 2.9 percent.

Corporate Profits

The profitability of corporate America is an important factor in estimating the revenues from the corporate license tax. There is a significant relationship between the profits reported by U.S. corporations and those taxed in Montana. Many of the large corporations operating in Montana are multi-state entities. During the most recent years, the reduction of corporate profits has translated to lower corporate license tax collections. According to Global Insight, between 1990 and 1997, U.S. corporation pre-tax profits increased by an annual average of 9.8 percent. However, from 1998 through 2001, profits have decreased by an average of 3.9 percent, the greatest decrease of 7.7 percent occurring in 2001. The reduction in corporate profits is projected to continue through 2002, at which time the outlook of corporate profitability is expected to begin a phase of slow improvement.



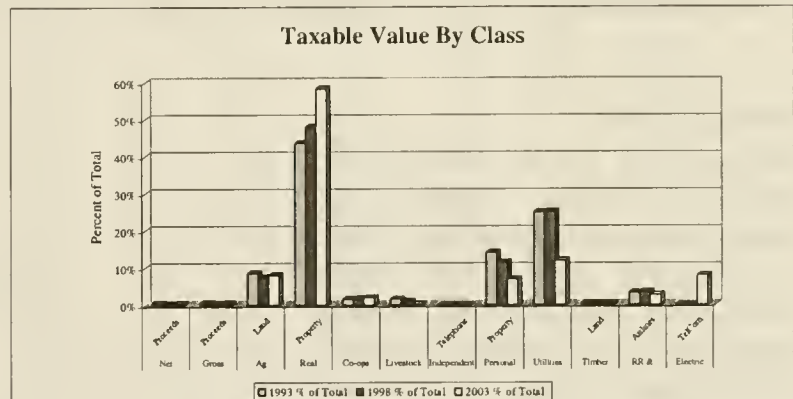
Property Values



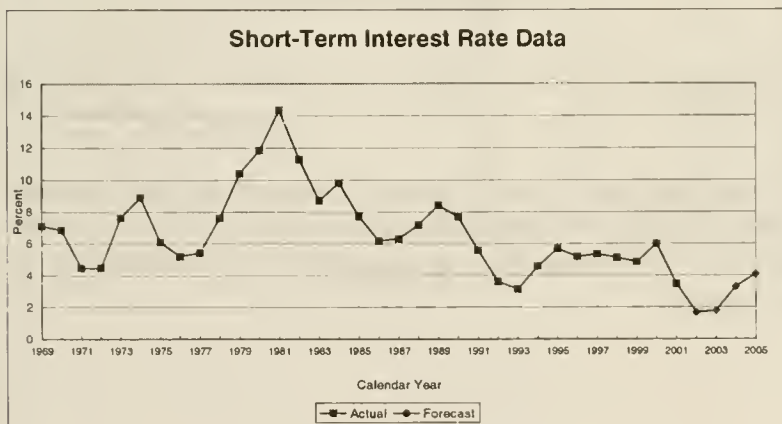
Change in statewide property values is the critical assumption behind the estimates for property taxes. Historic property values are obtained from the Montana Department of Revenue. Total statewide taxable value increased slowly during the first part of the 1990's but fell in both fiscal 2000 and 2001. This decline was primarily due to business equipment tax changes enacted by previous legislatures. Other reductions occurred in electrical generating and telecommunication property. Estimates for the 2005 biennium

show that statewide property values will resume a slow upward trend during the next biennium. Since detailed information on the effects of property reappraisal will not be available from the Department of Revenue until December, the 2005 biennium forecasts do not include the potential impacts of reappraisal.

Significant changes have taken place in statewide property values since fiscal 1998. In that year, 48.0 percent of total statewide value was in class 4, residential and commercial property, and 11.5 percent of total value was in class 8, business equipment personal property. In fiscal 2003, the class 4 taxable value is expected to make up 58.4 percent of the total property tax base, while class 8 will be only 7.0 percent of the base.



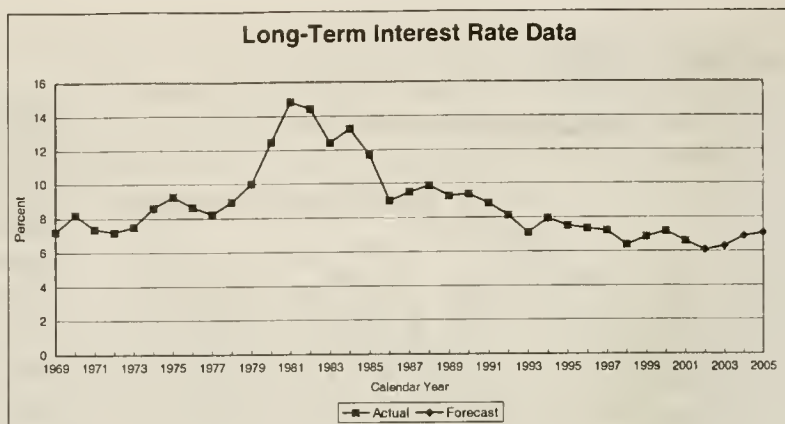
Interest Rates



A large portion of Montana's revenues is derived from investment earnings from trust accounts and daily cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. As such, interest rates are a significant assumption when estimating future state revenues.

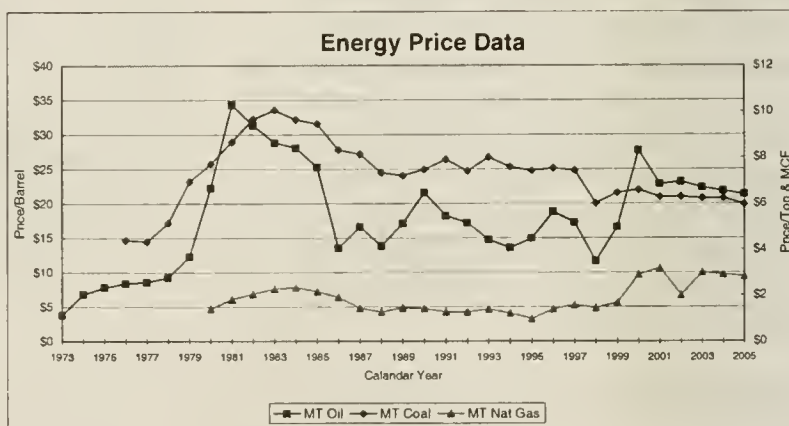
In addition to the state revenue impact, interest rates are fundamental in understanding the climate in which consumers and businesses are likely to make investments and large purchases. While low interest rates produce less revenue for Montana's trust and interest holdings, higher income tax earnings might be expected as construction and sales activities increase. Two types of interest rates, long and short term, are estimated and used in determining future revenues.

Both rates are an average across a selection of investment instruments. The forecasted rates are obtained from Global Insight. Long-term rates are an average of Corporate Aaa and Baa bonds, 10 year Treasury (T) bonds, and 30 year T bonds. Short term rates are an average of 3 and 6 month corporate paper and 3 and 6 month T bills. Long and short term interest rates have been on the decline since January 2001, when the Federal Reserve began reducing the discount rate. Rates are expected to reverse and begin an upward trend during the forecast period.



Energy Prices

Energy prices are very important to Montana's economy. Montana's rich bounty of energy land holdings plays an important part in the state's employment and economic stability. Additionally, the taxation of those commodities adds significant revenues to the state's coffers. Coal, oil, and natural gas production are each taxed on the value of production. Global Insight supplies information on coal, oil, and natural gas prices. Among the specific energy price indexes forecast by Global Insight are the *U.S. Refiner's Acquisition Price*, the *U.S. Minemouth Coal Price* and the *West Texas Oil Price*.



This information, plus conversations with industry experts, is used to develop Montana's energy prices. Since 1990, the price of Montana coal has decreased by 16.3 percent, oil has increased by 5.8 percent, and natural gas has increased by 123.5 percent. Estimates show a slow decline in the prices of all three of these commodities during the forecast period.

GENERAL FUND REVENUE ESTIMATES

Figure 6 and 7 show the RTIC general fund and non-general fund revenue recommendations for fiscal years 2003, 2004, and 2005. These recommendations are based on the major assumptions as discussed previously. From an economic perspective, these estimates reflect continuing slow growth in calendar 2002 and 2003 with a gradual recovery to more historic levels by calendar 2005.

Figure 6
Revenue and Transportation Interim Committee Recommendations
General Fund Revenue Estimates
In Millions

Source of Revenue	Percent of Total	Actual Fiscal 2002	Estimated Fiscal 2003	Estimated Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 02-03	Estimated Fiscal 04-05	Cumulative % of Total
1 Individual Income Tax	40.89%	\$517.568	\$527.400	\$556.874	\$594.339	\$1,044.968	\$1,151.213	42.24%
2 Property Tax	13.38%	169.339	173.277	180.179	186.420	342.616	366.599	56.08%
3 Corporation Income Tax	5.39%	68.173	53.814	64.782	69.223	121.987	134.005	61.01%
4 Vehicle Tax	5.78%	73.127	73.510	74.540	75.581	146.637	150.121	66.94%
5 Common School Interest and Income	3.87%	48.938	0.000	0.000	0.000	48.938	0.000	68.92%
6 Insurance Tax & License Fees	3.74%	47.291	51.446	56.038	58.441	98.737	114.479	72.91%
7 Coal Trust Interest	2.97%	37.605	36.825	37.249	37.920	74.430	75.169	75.92%
8 US Mineral Royalty	1.56%	19.772	22.679	23.407	22.903	42.451	46.310	77.63%
9 All Other Revenue	3.41%	43.216	25.808	18.783	18.877	69.024	37.660	80.42%
10 Tobacco Settlement	1.47%	18.647	19.025	3.105	3.182	37.672	6.287	81.95%
11 Telecommunications Excise Tax	1.55%	19.594	20.100	20.701	21.674	39.694	42.375	83.55%
12 Video Gambling Tax	3.45%	43.666	44.417	44.755	45.811	88.083	90.566	87.11%
13 Treasury Cash Account Interest	0.98%	12.414	10.811	13.476	16.844	23.225	30.320	88.05%
14 Estate Tax	1.09%	13.816	10.153	7.516	4.625	23.969	12.141	89.02%
15 Oil & Natural Gas Production Tax	1.02%	12.902	16.043	14.600	14.469	28.945	29.069	90.19%
16 Motor Vehicle Fee	2.15%	27.271	27.703	28.368	29.049	54.974	57.417	92.41%
17 Public Institution Reimbursements	1.13%	14.283	15.541	13.939	14.046	29.824	27.985	93.62%
18 Coal Severance Tax	0.67%	8.469	10.221	8.384	7.857	18.690	16.241	94.37%
19 Liquor Excise & License Tax	0.75%	9.514	9.854	10.239	10.624	19.368	20.863	95.15%
20 Cigarette Tax	0.62%	7.887	7.870	7.764	7.667	15.757	15.431	95.79%
21 Investment License Fee	0.39%	4.992	4.567	4.613	4.659	9.559	9.272	96.18%
22 Lottery Profits	0.59%	7.467	6.210	6.255	6.318	13.677	12.573	96.73%
23 Liquor Profits	0.44%	5.600	5.637	5.399	5.365	11.237	10.764	97.18%
24 Nursing Facilities Fee	0.47%	5.918	5.723	5.670	5.624	11.641	11.294	97.66%
25 Foreign Capital Depository Tax	0.00%	0.000	0.000	0.000	0.000	0.000	0.000	97.66%
26 Electrical Energy Tax	0.33%	4.197	4.329	4.408	4.483	8.526	8.891	98.00%
27 Metalliferous Mines Tax	0.26%	3.329	4.842	2.967	2.753	8.171	5.720	98.33%
28 Highway Patrol Fines	0.32%	4.062	4.142	4.224	4.308	8.204	8.532	98.66%
29 Public Contractors Tax	0.26%	3.267	2.679	3.354	3.356	5.946	6.710	98.90%
30 Wholesale Energy Tax	0.23%	2.906	3.373	3.432	3.492	6.279	6.924	99.16%
31 Tobacco Tax	0.17%	2.183	2.262	2.353	2.444	4.445	4.797	99.34%
32 Driver's License Fee	0.20%	2.580	2.355	2.373	2.391	4.935	4.764	99.53%
33 Railroad Car Tax	0.12%	1.490	1.577	1.688	1.681	3.067	3.369	99.66%
34 Wine Tax	0.10%	1.232	1.264	1.283	1.302	2.496	2.585	99.76%
35 Beer Tax	0.22%	2.784	2.918	3.058	3.205	5.702	6.263	99.99%
36 Telephone License Tax	0.02%	0.212	0.033	0.000	0.000	0.245	0.000	100.00%
37 Long Range Bond Excess	0.00%	0.000	0.000	0.000	0.000	0.000	0.000	100.00%
Total General Fund	100.00%	\$1,265.713	\$1,208.408	\$1,235.776	\$1,290.933	\$2,474.121	\$2,526.709	100.00%

Figure 7
Revenue and Transportation Interim Committee Recommendations
Non-General Fund Revenue Estimates
 In Millions

Source of Revenue	Percent of Total	Actual Fiscal 2002	Estimated Fiscal 2003	Estimated Fiscal 2004	Estimated Fiscal 2005	Estimated Fiscal 02-03	Estimated Fiscal 04-05	Cumulative % of Total
1 Diesel Tax	17.83%	\$58.261	\$59.180	\$60.041	\$60.903	\$117.441	\$120.944	18.14%
2 Federal Forest Receipts	4.12%	13.475	13.583	13.775	13.976	27.058	27.751	22.30%
3 Gasoline Tax	40.32%	131.731	132.446	133.185	133.918	264.177	267.103	62.35%
4 GVW and Other Fees	8.35%	27.266	27.037	26.729	26.377	54.303	53.106	70.32%
5 Lodging Facility Use Tax	3.64%	11.901	12.441	13.005	13.595	24.342	26.600	74.30%
6 Resource Indemnity Tax	0.67%	2.201	1.080	1.055	1.062	3.281	2.117	74.62%
7 Arts Trust Interest	0.09%	0.305	0.314	0.322	0.337	0.619	0.659	74.72%
8 Capital Land Grant Interest and Income	0.34%	1.101	0.827	0.822	0.613	1.928	1.435	74.94%
9 Deaf & Blind Interest and Income	0.09%	0.284	0.292	0.295	0.298	0.576	0.593	75.02%
10 Parks Trust Interest	0.34%	1.106	1.114	1.127	1.153	2.220	2.280	75.37%
11 Pine Hills Interest and Income	0.11%	0.355	0.348	0.358	0.363	0.703	0.721	75.47%
12 RIT Trust Interest	2.24%	7.321	7.376	7.377	7.379	14.697	14.756	77.69%
13 TSE Trust Interest	2.08%	6.805	7.201	7.871	8.472	14.006	16.343	80.14%
14 Property Tax: 6 Mill	3.61%	11.806	11.627	11.989	12.292	23.433	24.281	83.78%
15 Property Tax: 9 Mill	0.09%	0.286	0.000	0.000	0.000	0.286	0.000	83.78%
16 Tobacco Trust Interest	0.30%	0.968	1.741	2.464	3.253	2.709	5.717	84.64%
17 Regional Water Trust Interest	0.20%	0.643	1.151	1.404	1.670	1.794	3.074	85.10%
18 Common School Interest and Income	15.57%	50.875	51.175	49.745	49.631	102.050	99.376	100.00%
Total Non-General Fund	100.00%	\$326.689	\$328.933	\$331.564	\$335.292	\$655.622	\$666.856	100.00%

It should be noted that the RTIC discussed the two issues shown in Figure 8. By their formal actions, the committee did not include any of these potential revenues in the revenue estimate for the 2005 biennium. These issues were discussed, but the committee did not believe they had sufficient information to include them in the 2005 biennium revenue estimates. Since further information would be available after the convening of the 58th Legislature, the committee deferred any action on these issues to the House Taxation Committee.

Figure 8
Significant Revenue Issues
Action By Revenue and Transportation Interim Committee
 In Millions

Revenue Issue	RTIC Action	Potential Revenue Impact 2003,2004,2005
Property Reappraisal Impacts	Did Not Include	\$9.815
Consumer Protection Litigation	Did Not Include	<u>\$5.500</u>
Total		\$15.315

2005 BIENNIUM PROJECTION

Figure 9 shows the projected present law general fund balance for the 2005 biennium. Amounts shown include the revenue estimates as adopted by RTIC on November 19, 2002, and the cost of operating state government based on present law requirements. These disbursement amounts are as proposed in the Executive Budget. However, any present law adjustments that reduced services were categorized as a new proposal. These negative present law adjustments have been combined with all other new proposals and are shown in Figure 11. The present law amounts shown for both anticipated revenues and expenditures do not include any positive new proposals or initiatives recommended by the executive.

Figure 9 2005 Biennium General Fund Balance Present Law Only In Millions	
	Estimated 2005 Biennium
Beginning Fund Balance	\$4,357
Revenues	
Current Law Revenue	2,526,709
Total Funds Available	\$2,531,066
Disbursements	
General Appropriations	
Human Services	583,665
Corrections	217,133
Higher Education	290,256
Public Schools	1,029,848
Other Government	293,699
Statutory Appropriations	268,118
Non-Budgeted Transfers	31,780
Feed Bill Appropriations	6,699
Anticipated Reversions	(8,191)
Total Disbursements	\$2,713,007
Ending Fund Balance Before Reserve	(\$181,941)
Proposed Executive Budget Reserve	(\$50,060)
Projected Present Law Deficit	(\$232,001)

LFD COMMENT

Present law is defined in statute as “that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature.” The concept of present law versus new proposals allows the legislature to examine requested adjustments from a perspective of a “necessary” change to a “desired” change. This distinction assists the legislature in formulating a budget that focuses on existing services before any new initiatives or programs are considered.

LFD ISSUE

Although the executive is requesting supplemental appropriations of \$15.7 million for fiscal 2003, their fund balance statement for the 2005 biennium does not include any anticipated supplemental or emergency appropriations. Supplemental appropriations have never been less than \$11.5 million for the last 7 biennia and have never been included in the balanced budget plan.

As Figure 9 shows, the 2005 biennium ending general fund balance is projected to be a negative \$232 million before any new proposals or initiatives are considered. This balance indicates the state cannot maintain the existing level of services without a reduction in services, revenue enhancements, or a combination of both.

Figure 10 shows the allocation of general fund dollars to functional areas provided the funds were available to fund present law costs. As the chart indicates, educational services consume almost 49 percent of total general fund expenditures, with human service and correctional services expending nearly 30 percent. All other governmental agencies expend almost 11 percent, with the remaining 11 percent expended by statutory appropriations for debt service, retirement systems, and local government reimbursements. For more information on statutory appropriations and non-budgeted transfers, see page 129.

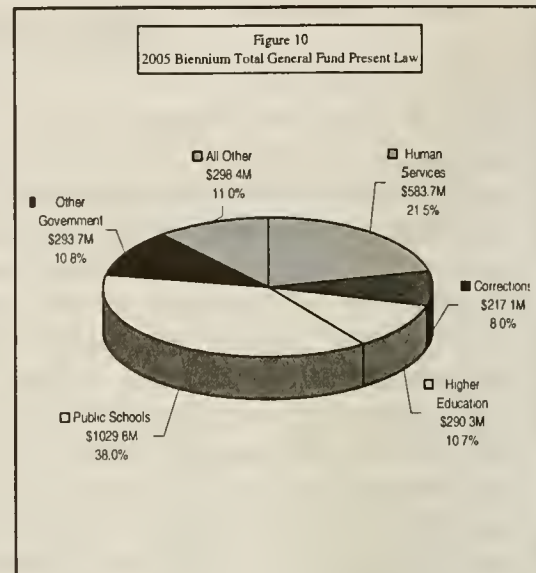


Figure 11
2005 Biennium General Fund Balance
With Executive New Proposals
In Millions

	Estimated Fiscal 2004	Estimated Fiscal 2005	Estimated 2005 Biennium
Beginning Present Law Balance	(\$181.941)	(\$66.864)	(\$181.941)
Executive Revenue Proposals			
State Fund Transfer	13.480	3.780	17.260
Extend Coal, Oil&Gas, Metal Reallocation	4.250	4.000	8.250
Oil and Gas Accrual	3.000		3.000
Terminate Infrastructure Credit	2.000		2.000
Permanent Coal Trust Transfer	93.000	(6.720)	86.280
Coal Tax Trust Reallocation	(0.130)	(0.390)	(0.520)
Reduced Revenue Due Expenditure Proposals	<u>(0.531)</u>	<u>(0.378)</u>	<u>(0.909)</u>
Total Revenue Proposals	\$115.069	\$0.292	\$115.361
Executive Disbursement Proposals			
General Appropriations			
Human Services	(25.343)	(27.118)	(52.461)
Corrections	(5.217)	(2.058)	(7.275)
Higher Education	(7.925)	(8.957)	(16.882)
Public Schools	(9.635)	2.810	(6.825)
Other Government	(6.588)	(8.427)	(15.015)
Cultural and Aesthetic Grants	0.250	0.250	0.500
Department of Transportation Transfers	(2.960)	(3.010)	(5.970)
Research & Commercial, Growth Agriculture	(4.190)	(4.190)	(8.380)
Executive Pay Proposal	<u>3.740</u>	<u>5.940</u>	<u>9.680</u>
Total Disbursement Proposals	(\$57.868)	(\$44.760)	(\$102.628)
Total Executive New Proposals	\$172.937	\$45.052	\$217.989
Ending Balance Before Reserve	(\$9.004)	(\$21.812)	\$36.048
Executive Proposed Ending Fund Reserve	57.860	50.060	50.060
Difference From Proposed Reserve	(\$66.864)	(\$71.872)	(\$14.012)

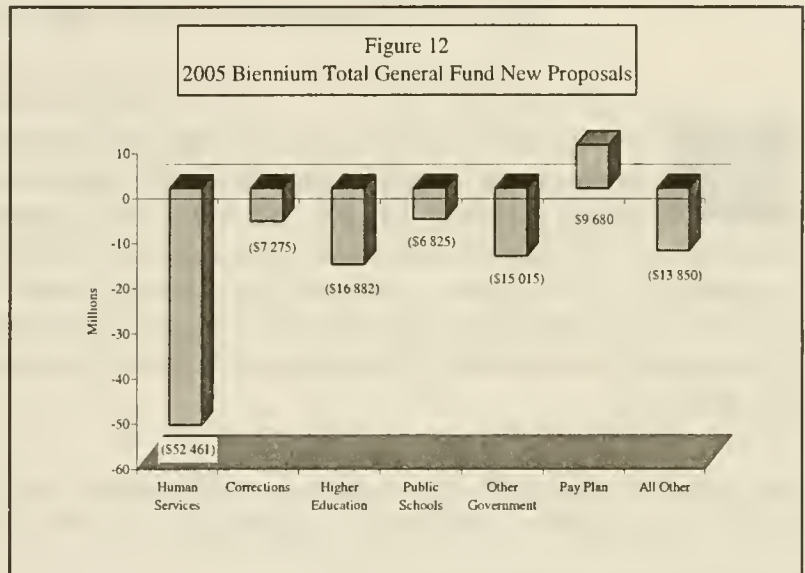
Figure 11 shows the projected general fund balance with the executive new proposals and initiatives included. The executive new proposals are categorized as either a revenue or disbursement proposal. Since the present law budget is negative, the total budget solution for all of the executive new proposals is \$218.0 million. This amount, combined with the available present law balance, results in an ending balance of \$36.0 million or \$14 million less than the executive's recommended ending fund balance reserve of \$50.1 million.

**LFD
ISSUE**

The Executive Budget includes several temporary and phased-in proposals that impact the 2007 biennium budget. This is because the temporary revenue initiatives will not be available next biennium, while the phased-in disbursements will cost significantly more in future biennia. This means the 2005 legislature will be faced with funding additional services above the 2005 biennium costs. A biennium budget should not be developed with significant cost increases in the second year of the biennium without a corresponding revenue adjustment.

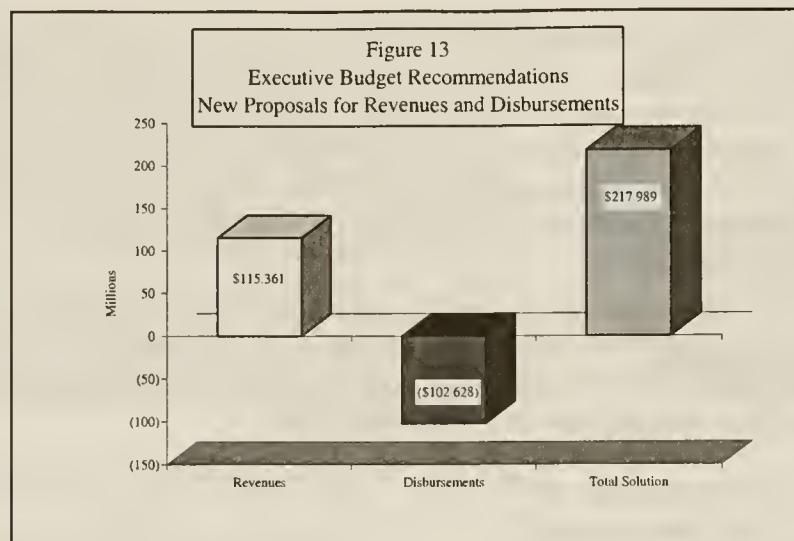
Figure 12 shows the allocation of all new proposal expenditure reductions to functional areas. As the chart depicts, the Executive Budget allocates the largest dollar reductions to human services, higher education, and other governmental agencies. Corrections and public school funding are recommended for the least reduction when compared to the other three areas.

The new proposal recommendations of the executive include both revenue and disbursement types. Figure 13 on the next page, graphically portrays the dollar impact of these proposals. As shown in the chart, disbursement and revenue initiatives are approximately equal for a combined solution of \$218.0 million. When this amount is combined with the present law deficit of \$232 million, the Executive Budget (if adopted) would create a general fund balance of \$36.0 million or \$14.0 million below their recommended reserve.



DIFFERENCES FROM EXECUTIVE PROPOSAL

The Executive Budget as submitted projects an ending fund balance of \$50.1 million after funding all executive present law adjustments and new proposals. This contrasts with Figure 11, which shows a general fund balance of \$36.0 million, or a difference of \$14.0 million. This balance is based on the RTIC revenue estimates, LFD estimates for statutory appropriations and reversions, and the executive's recommendations for all present law adjustments and new proposals. As advocated by the LFD in the past, an adequate reserve is necessary for unexpected occurrences including emergencies, fire suppression costs, supplemental appropriations, or lower than expected revenue collections.


**LFD
ISSUE**

The executive general fund budget for the 2005 biennium is over \$2.6 billion. The recommended ending fund reserve is \$50.1 million, or approximately 1.9 percent of total disbursements. This balance is insufficient when the events of the current biennium are considered. The total revenue shortfall during fiscal 2002 (\$64.8) million would deplete this balance in its entirety. The legislature may wish to consider whether this recommended reserve is sufficient to ensure budget stability and control of the budget decision-making process. A reserve of 3 to 5 percent is generally recommended by experts and is commonly practiced by other states. (see page 140, for more details)

As shown in Figure 14, there are a number of items that contribute to the total difference of \$14.0 million. Each of these differences is explained in the next section.

Explanation of Differences

General Fund Revenue - The combined differences of all general fund sources between the RTIC adopted estimates and the executive are \$9.7 million. This difference is primarily due to the committee's reluctance to include any impacts of property reappraisal and consumer litigation efforts.

General Appropriations/Miscellaneous Appropriations - The net difference between these appropriation items is \$14.7 million. The executive included the 17-7-140, MCA spending reductions in the general appropriations category, while the LFD included these reductions in the anticipated reversion category.

Figure 14
Differences From Executive Budget
Fiscal 2003, 2004, 2005
In Millions

Fund Balance Category	3 Year Difference
Beginning Fund Balance	\$0.018
Revenues	(9.702)
Disbursements	
General Appropriations	(14.730)
Statutory Appropriations	(4.058)
Non-Budgeted Transfers	0.116
Supplemental Appropriations	0.004
Anticipated Reversions	14.323
Total Differences	(\$14.029)

Statutory Appropriations - The difference in this category is due to the information received from agencies that administer statutory appropriations. In most instances, the executive and the LFD relied on information supplied by the respective agencies. Because the executive is required to submit the executive budget by November 15th, the LFD had more current information available.

Non Budgeted Transfers – The difference between this category is minimal.

Anticipated Reversions – The difference in this category is \$14.3 million. The executive included the 17-7-140, MCA reductions in the general appropriations category while the LFD included these reductions in the anticipated reversion category.

Summary

In summary, if the RTIC revenue estimate recommendations were adopted by the legislature, the general fund present law balance would be a negative \$232.0 million. A balance in the general fund of \$36.0 million would occur if the legislature adopted the executive’s recommendations for all new proposals and initiatives, \$14.0 million below the executive recommended ending reserve. This would therefore require either a reduction in services provided via reduced expenditures, revenue enhancements, and/or a lower reserve below \$50.1 million to eliminate the difference.

PROJECTED GENERAL FUND BALANCE

Figure 15 shows the detailed general fund balance sheet based on present law revenues and disbursements, followed by a sub-table that shows the balance when the executive’s new proposals are included. The \$50.1 million reserve as proposed by the executive is not shown in this table.

Figure 15
2005 Biennium General Fund Balance
Based on Present Law
 In Millions

	Actual Fiscal 2002	Estimated Fiscal 2003	Estimated Fiscal 2004	Estimated Fiscal 2005	Estimated 2003 Biennium	Estimated 2005 Biennium
Beginning Fund Balance	\$172.897	\$83.228	\$4.357	(\$110.274)	\$172.897	\$4.357
Revenues						
Current Law Revenue	1,265.713	1,208.408	1,235.776	1,290.933	2,474.121	2,526.709
Total Funds Available	\$1,438.610	\$1,291.636	\$1,240.133	\$1,180.659	\$2,647.018	\$2,531.066
Disbursements						
General Appropriations	1,120.576	1,058.569	1,206.820	1,207.779	2,179.145	2,414.599
Statutory Appropriations	149.108	125.950	133.219	134.899	275.058	268.118
Miscellaneous Appropriations	68.016	84.495			152.511	
Non-Budgeted Transfers	18.768	9.044	14.462	17.318	27.812	31.780
Continuing Appropriations	2.611	5.415			8.026	
Supplemental Appropriations		15.686			15.686	
Feed Bill Appropriations		8.622		6.699	8.622	6.699
Anticipated Reversions	(3.176)	(20.502)	(4.094)	(4.097)	(23.678)	(8.191)
Total Disbursements	\$1,355.903	\$1,287.279	\$1,350.407	\$1,362.598	\$2,643.182	\$2,713.005
Adjustments	0.521				0.521	
Reserved Ending Fund Balance	\$83.228	\$4.357	(\$110.274)	(\$181.939)	\$4.357	(\$181.939)
Unreserved Ending Fund Balance	\$83.228	\$4.357	(\$110.274)	(\$181.939)	\$4.357	(\$181.939)
Net Operations	(\$90.190)	(\$78.871)	(\$114.631)	(\$71.665)	(\$169.061)	(\$186.296)

New Executive Proposals Not Included Above						
Revenue Initiative			\$115.069	\$0.292		\$115.361
Disbursement New Proposals						
Present Law Reductions			16.229	17.496		33.725
New Proposal Increase			(8.834)	(13.339)		(22.173)
New Proposal Decrease			47.314	39.593		86.907
Other Proposals			<u>3.160</u>	<u>1.010</u>		<u>4.170</u>
Total Disbursement Initiative			57.869	44.760		102.629
Potential Ending Fund Balance Without Reserve			\$62.664	\$36.051	\$4.357	\$36.051

EXECUTIVE BUDGET ANALYSIS

LFD Statewide Summary

Budget Overview
Revenue and Tax Policy Proposals
Expenditure Proposals
Statewide Budget Proposals/Issues
Other LFD Issues





EXECUTIVE BUDGET OVERVIEW

INTRODUCTION

This chapter is an overview of the budget submitted for the 2005 Biennium by Governor Martz, pursuant to statute. This overview provides a summary of the more detailed agency budget presentation contained in Volumes 3 and 4 of the Legislative Fiscal Division Budget Analysis. It is intended to provide the reader with a general understanding of the major components of the budget. This and subsequent sections of this chapter include the following:

- Highlights of revenue and expenditure proposals
- Comparisons with the previous biennium
- Executive revenue and tax policy proposals
- Executive expenditure proposals
- Statewide budget proposals and issues
- Other Executive Budget issues identified through Legislative Fiscal Division analysis

HIGHLIGHTS OF THE PROPOSED BUDGET

The Governor's budget reflects a 1.8 percent general fund increase and a 7.5 percent increase in total funds over the 2003 biennium. The budget is a combination of increases and decreases in the various program areas, but the low net increase in general fund expenditures is clearly the result of significant proposed reductions (a net of \$120.6 million) in funding for state present law spending. The largest general fund dollar increases appear in the Judiciary and Corrections. The largest total fund increases occur in Transportation and Public Health and Human Services.

The highlights of the proposed budget are:

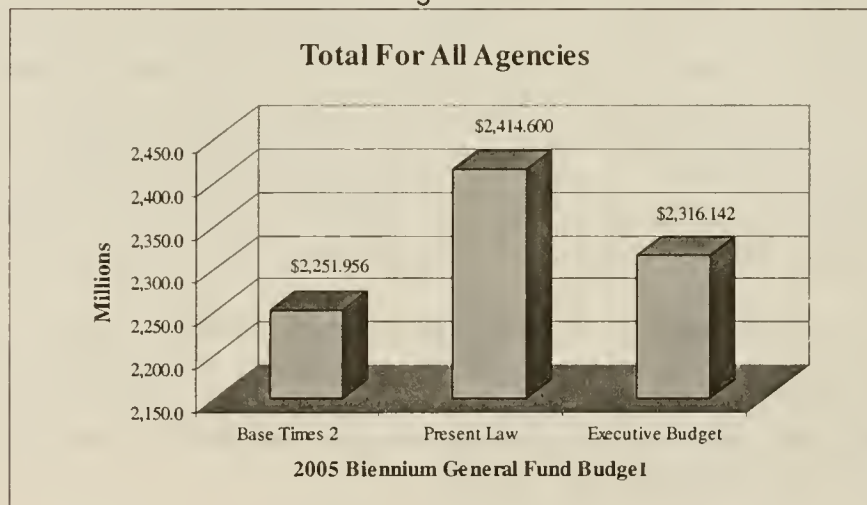
- **Human Services.** Human services would increase \$222.2 million, or 11.3 percent. General fund would increase \$5.7 million, or 1.1 percent. The relatively low increase in general fund spending authority occurs because what would have been significant increases in health care costs and program caseloads are offset by significant reductions in program operations and services and refinancing efforts that are aimed at balancing the budget. Increases in other funds of nearly \$217 million reflect \$20.2 million additional state special revenue that comes largely from tobacco settlement monies and refinancing, and a net of \$196.3 million federal funds that relate to various programs including Medicaid, food stamps and bio-terrorism grants.
- **Education.** General fund for K-12 education would decrease \$53.2 million; total funds decrease \$6.8 million. However, the decreases are primarily a result of the earmarking of over \$45 million of state equalization funds that occurred in the special session in August 2002. Monies that were deposited and appropriated to the general fund are now statutorily appropriated from a special revenue account.

- The remaining almost \$8.0 million decrease is due to enrollment decreases and other factors. When adjusted for the change in fund designation, K-12 education shows a smaller general fund decrease of 0.7 percent, and total funds would increase by 3.1 percent
- **Higher Education.** Governor Martz nearly holds the line on general fund, including only a \$376,498 or 0.1 percent increase for higher education. Total funds decrease \$5.2 million or 1.3 percent.
- **Corrections.** Governor Martz proposes adding general fund of \$14.7 million, or 7.5 percent, primarily due to increasing populations.
- **Judiciary.** The Executive Budget includes a \$20.3 million general fund increase, most of which results from the state assumption of district courts.
- **Long-Range Building Program (LRBP).** The LRBP request is for \$46.1 million, entirely for "cash" projects. The LRBP budget proposal contains no bonded projects. \$2.3 million is from the Long-Range Building Program Account, which is funded primarily from coal severance and cigarette taxes.
- **Local Government Entitlements.** The Governor provides funding for local government entitlements as provided in statute, including inflationary increases of \$7.5 million.

BUDGET LEVEL COMPARISON

In this volume and Volumes 3 and 4, the reader will see references to base budget, present law budget, and the Executive Budget. Important to consider is the relationship between these different looks at the budget. Base budget describes the actual costs for the base year (fiscal 2002). The present law budget, the amount of funding needed to maintain government services at the level authorized by the previous legislature, is developed for the upcoming biennium, which includes fiscal 2004 and fiscal 2005. The Executive Budget is the budget that is submitted to the legislature for the upcoming biennium and, by statute, must include the components of base and present law, plus the addition of any new proposals that the Governor wishes to pursue. These three different levels of the budget are compared in Figure 1.

Figure 1



The base is represented as the base budget times two in order to compare on a biennium basis, and because the fiscal 2004 and fiscal 2005 budgets are developed from the base budget data. Figure 1 shows that the present law budget exceeds the base budget by \$162.6 million, reflecting adjustments to the base for such things as annualization of the 2003 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The Executive Budget, which reflects the executive's efforts to balance the budget due to the revenue shortfall, is \$98.5 million less than the present law budget, resulting from \$120.6 million in present law reductions, offset by \$22.2 million in positive new proposals. The Executive Budget is \$64.2 million greater than the base budget.

HOW THE EXECUTIVE BUDGET ADDRESSES THE SHORTFALL

Figure 2 provides a summary of the actions suggested by the Executive Budget that are intended to provide for a balanced budget for the 2005 biennium. A page reference at the right of each listed item directs the reader to a further description of the action item. This figure gives the reader a high level look at the variety of budget balancing measures the executive employed in the development of the proposed budget. There is a net of \$218 million in budget balancers, which would leave an ending fund balance of \$36 million. As shown in the table, the executive proposal includes \$102.6 million in net expenditure reductions and \$115.4 million in revenue solutions (transfers from other funds, such as the coal tax trust and state fund, are classified as revenue sources for this purpose).

Figure 2
Executive Proposed General Fund Deficit Mitigation Measures
2005 Biennium
in Millions

Component	Detail Subtotal	Total	Page Number
Projected Deficit		\$ (232.001)	45
Ending Fund Balance Projection		<u>50.06</u>	
Subtotal Deficit Without Ending Fund Balance Projection		\$ (181.941)	
Revenue Proposals			
Fund Balance Transfer		\$ 103.540	
State Fund	17.260		75
Permanent Coal Tax Trust (net of interest impact)	86.280		79
Diversions to the General Fund - Extend Coal, Oil & Gas, Metal Reallocations*		8.250	77
Oil and Gas Accrual		3.000	78
Terminate Infrastructure Credit		2.000	79
Coal Tax Trust Reallocation		-0.520	77
Revenue Reduction due to Expenditure Proposals		<u>-0.909</u>	85
Total Revenue Measures		\$ 115.361	
Disbursement Proposals			
Cultural and Aesthetic Grants		-0.500	E-56
Eliminate Transfers from the General Fund		14.350	
Transportation	5.970		76
Research and Commercialization/Growth Through Agriculture*	8.380		76
Pay Plan Proposal/Personal Services Contingency		-9.680	95
HB 2 Reduction Measures		120.628	
Fee Increases	2.679		106
Funding Switches	21.069		109
Specific Service Reductions	38.560		105
Unspecified Montana University System Reductions**	17.270		70
Miscellaneous/Other Unspecified Reductions	41.050		122
HB 2 Positive New Proposals		<u>-22.170</u>	
Total Disbursement Measures		\$ 102.628	
Total Executive Deficit Mitigation Measures		<u>217.989</u>	
Projected Actual Ending Fund Balance - Executive Budget		<u>\$ 36.048</u>	

*Some reductions in service will also result.

**The executive offsets enrollment increases with a like reduction in the same decision package. If the enrollment had been appropriately added in present law and reduced in a new proposal, the resulting unspecified reduction would total \$25.4 million.

BIENNIAL BUDGET COMPARISON

This section summarizes executive recommendations in comparison to expenditures for the preceding biennium.

The executive is recommending a 2005 biennium budget that includes an additional \$45.4 million general fund, a 1.8 percent increase. Total requested increases (all funds) amount to \$471.5 million, a 7.5 percent spending increase. The executive proposal for general fund and total spending increases is supported by existing sources of revenue, with the minimal general fund increase being indicative of the reduced revenues from individual and corporate income taxes. Although "present law" adjustments dictate increases beyond the state's fiscal capacity, numerous "proposed law" adjustments for program operations and services reductions largely offset the statutorily required present law adjustments, as the executive pursues a balanced budget.

COMPARISON METHODOLOGY

The state budget is highly complex, and the methods used to compute comparisons within the context of that budget can vary considerably. Without consistent comparison methodology, the comparisons can also be subject to manipulation. The Legislative Finance Committee (LFC) developed a budget comparison methodology that measures budget performance using total state expenditures for state general operations funded by taxpayer taxes, licenses, and fees. This method helps ensure proper representation, fairness, balance, and consistency. Adopted by the 1997 legislature, use of the comparison procedures became a statutory requirement at that time. These procedures provide consistency of application and help avoid the potential for manipulation when comparing information.

The comparisons on the following pages were prepared using the statutory methodology. A discussion of budget comparison methodology and the statutory requirements is included in the Budget Basics Section of this volume.

COMPARISON TO 2003 BIENNIUM

Figures 3 and 4 compare expenditures between the 2003 to 2005 biennia for general fund and total funds. As shown in the tables, the largest general fund increases are found in the Department of Corrections and the Judiciary. Education (K-12) shows the largest general fund decrease, most of which is the result of the shift of certain general fund revenue sources to a state special revenue account.

The following figures (3 and 4) are divided into three sections:

1. The top part of the table includes all appropriations recommended for inclusion in HB 2 (the General Appropriations Act), by agency.
2. Because HB 2 does not include all appropriations authorized by the legislature, the second part of the table includes additional executive recommendations. This section is referred to as "Comparable Adjustments," because the items can be compared across biennia. The total shown in the "Total Executive Budget Fiscal 04-05" (2005 biennium) column represents all recommendations made by the executive, with the exception of the non-cash portion of Long-Range Building proposals and statutory appropriations. Long-Range Building proposals are specifically excluded because spending and timing vary considerably on most building projects.

The building expenditures are reflected by the debt service paid over the term of any bonding/leasing agreement. Statutory appropriations represent the executive request with adjustments made by the Legislative Fiscal Division for Revenue and Taxation Committee estimates and updated information. (Note: The total in the "Total Adjusted Fiscal 02-03" (2003 biennium) column does not represent all contingent appropriations in that biennium, which are included in the third section.)

3. The third section, "Non-comparable Adjustments," includes all 2003 biennium appropriations, including budget amendments, supplemental appropriations, and disaster/emergency costs that cannot be estimated for the next biennium. Excluded from the comparable adjustments total are probable 2005 biennium expenditures that belong in this category. Consequently, the comparisons do not represent a true picture of potential growth between biennia.

House Bill 2 Comparisons

As shown in Figures 3 and 4, general fund recommendations in HB2 increase 2.3 percent, and all funds reflect an increase of 7.8 percent, with \$189.4 million of increases in state special revenue and \$202.5 million in federal special revenue. These are primarily due to additional state special expenditures in the Department of Transportation (\$121.0 million), and the Department of Public Health and Human Services (\$20.2 million), and additional federal funds expenditures in K-12 education (\$38.2 million) and Public Health and Human Services (\$196.3 million). The \$77.6 million total funds reduction shown for the Department of Commerce is primarily due to a change in how federal housing funds are accounted for in the state accounting system, which change from a federal account to a proprietary account.

Expenditure increases are summarized in the "Expenditure Proposals" section of this volume, page 63, and are detailed in the narratives of the specific agencies in Volumes 3 and 4.

As shown in Figure 3, the executive general fund recommendations for HB 2 increase by \$5.6 million, or 0.24 percent, from the 2003 biennium. If adjusted for the funding shift in K-12 education funding, the general fund increase is \$51.2 million, or a 2.3 percent increase. These increases includes a net reduction of \$64.7 million from new proposals, most of which suggest program operation and services reductions.

Total funds (Figure 4) increase by \$441.9 million, or 7.8 percent. See page 65 of this volume for a table and discussion of present law adjustments and new proposals.

Total Comparable Adjustments

Total comparable adjustments include HB2 and all miscellaneous appropriations including the employee pay plan bill and other appropriations bills, statutory appropriations, and other expenditures and adjustments. The executive recommends \$45.4 million in increased general fund expenditures for the 2005 biennium as compared to the 2003 biennium, an increase of 1.8 percent. The increase in total all funds spending over comparable 2003 biennium spending is \$471.5 million, or 7.5 percent.

Non-Comparable Adjustments

Non-comparable Adjustments, the third section, shows increases of 0.64 percent general fund and 4.7 percent total funds between biennia. As stated earlier, this comparison tends to be distorted by the lack of comparable information for the 2005 biennium. This section and these comparisons are shown for informational purposes only and to complete the listing of 2003 biennium expenditures.

COMPARISON CAUTION

Comparisons vs. Budget Base Adjustments

This section compares the 2005 biennium Executive Budget to actual expenditures and adjusted fiscal appropriations for the 2003 biennium. The methodology used is that prescribed by the budget comparison statute, and upholds the concept of a comparison of the total state budget from biennium to biennium. This is a particularly useful practice due to the cyclical nature of annual budgets. However, because the Executive Budget is prepared using a different statutorily defined process, there is a difference between the total changes indicated in this volume and those indicated in the individual agency and program budgets discussed in the Agency Budgets and Analysis Section in Volumes 3 and 4.

Because present law adjustments are added to the base year (fiscal 2002) to determine a present law budget for the 2005 biennium and budget growth as prescribed by total adjustments, the intermediate year (fiscal 2003) is ignored. This method facilitates budget development from a vantage point of recent, actual experience, but overstates true budget growth because all increases are measured from the base year.

Conversely, using the base year (2002) plus fiscal 2003 appropriations for budget comparisons more accurately reflects true budget growth. This is because the increases/decreases are measured from a biennial perspective that takes into account the annual increase from the base year to the fiscal 2003 appropriated amount.

While consideration of increases over the base year is necessary to making budgetary decisions, the adjustments should not be used as measures of growth or for comparative purposes. When making comparisons, the total recommended budget for the 2005 biennium should be examined in comparison with the total 2003 biennium, as described in the preceding paragraph.

Figure 3
General Fund Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	\$15,896,490	\$17,765,704	\$1,869,214	11.76%
2110	Judiciary	38,191,290	58,535,818	20,344,528	53.27%
3101	Governor's Office	8,368,227	8,619,692	251,465	3.00%
3202	Commissioner of Political Prac	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	658,140	0	(658,140)	-100.00%
3501	Office of Public Instruction	1,076,198,614	1,023,021,758	(53,176,856)	-4.94%
4107	Crime Control Division	3,608,569	3,292,188	(316,381)	-8.77%
4110	Department of Justice	40,308,016	46,306,640	5,998,624	14.88%
5101	Board of Public Education	341,818	312,141	(29,677)	-8.68%
5102	Commissioner of Higher Ed	272,998,574	273,375,072	376,498	0.14%
5113	School for the Deaf & Blind	6,913,790	7,012,990	99,200	1.43%
5114	Montana Arts Council	658,135	601,848	(56,287)	-8.55%
5115	Library Commission	3,569,077	3,535,405	(33,672)	-0.94%
5117	Historical Society	3,645,083	3,488,665	(156,418)	-4.29%
5201	Dept. of Fish, Wildlife & Parks	559,307	511,867	(47,440)	-8.48%
5301	Dept of Environmental Quality	7,479,706	7,082,497	(397,209)	-5.31%
5401	Department of Transportation	0	0	0	
5603	Department of Livestock	1,150,748	1,059,723	(91,025)	-7.91%
5706	Dept Nat Resource/Conservation	28,146,201	35,746,355	7,600,154	27.00%
5801	Department of Revenue	57,555,923	60,431,020	2,875,097	5.00%
6101	Department of Administration	8,254,908	7,578,418	(676,490)	-8.20%
6102	Appellate Defender	183,760	377,492	193,732	105.43%
6201	MT Dept of Agriculture	1,486,641	1,351,105	(135,536)	-9.12%
6401	Dept of Corrections	195,203,921	209,856,878	14,652,957	7.51%
6501	Department of Commerce	3,760,840	4,406,232	645,392	17.16%
6602	Labor & Industry	3,143,831	3,724,020	580,189	18.45%
6701	Dept of Military Affairs	6,042,205	6,304,555	262,350	4.34%
6901	Public Health & Human Services	525,526,015	531,203,907	5,677,892	1.08%
Total		\$2,310,536,294	\$2,316,142,428	\$5,606,134	0.24%
Adjusted for OPI Fund Switch		\$2,264,895,677	\$2,316,142,428	\$51,246,751	2.26%
Comparable Adjustments					
Employee Pay Proposal		In Above	9,680,000	9,680,000	
Statutory Appropriations		261,782,818	262,510,000	727,182	0.28%
Legislative Session Costs		8,621,661	6,699,000	(1,922,661)	-22.30%
Miscellaneous Appropriations		11,731,000	499,150	(11,231,850)	-95.75%
One-Time Only Costs		17,416,133		(17,416,133)	-100.00%
Anticipated Reversions		(23,678,000)	(9,370,000)	14,308,000	-60.43%
Total With Comparable Adjustments		\$2,540,769,289	\$2,586,160,578	\$45,391,289	1.79%
Non Comparable Adjustments					
Budget Amendments		0		0	
Supplementals		15,685,523		(15,685,523)	-100.00%
Disaster/Emergency Costs		13,275,001		(13,275,001)	-100.00%
Total With All Adjustments		\$2,569,729,814	\$2,586,160,578	\$16,430,764	0.64%

Figure 4
All Funds Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	\$19,978,468	\$21,789,183	\$1,810,715	9.06%
1112	Consumer Counsel	2,256,504	2,428,954	172,450	7.64%
2110	Judiciary	41,477,075	64,579,669	23,102,594	55.70%
2115	Mt.Chiropractic Legal Panel	18,776	30,000	11,224	59.78%
3101	Governor's Office	11,162,946	12,020,882	857,936	7.69%
3202	Commissioner of Political Prac	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	7,317,730	8,512,127	1,194,397	16.32%
3501	Office of Public Instruction	1,291,631,586	1,284,796,519	(6,835,067)	-0.53%
4107	Crime Control Division	26,429,354	24,134,094	(2,295,260)	-8.68%
4110	Department of Justice	99,308,522	109,062,308	9,753,786	9.82%
4201	Public Service Regulation	5,942,027	5,459,453	(482,574)	-8.12%
5101	Board of Public Education	666,167	683,996	17,829	2.68%
5102	Commissioner of Higher Ed	391,955,729	386,748,185	(5,207,544)	-1.33%
5113	School for the Deaf & Blind	7,672,716	7,890,140	217,424	2.83%
5114	Montana Arts Council	1,891,381	2,111,373	219,992	11.63%
5115	Library Commission	6,869,536	7,622,308	752,772	10.96%
5117	Historical Society	7,886,433	7,850,539	(35,894)	-0.46%
5201	Dept. of Fish, Wildlife & Parks	94,035,448	114,309,086	20,273,638	21.56%
5301	Dept of Environmental Quality	108,707,944	123,619,655	14,911,711	13.72%
5401	Department of Transportation	996,064,778	1,128,845,704	132,780,926	13.33%
5603	Department of Livestock	15,932,488	18,348,945	2,416,457	15.17%
5706	Dept Nat Resource/Conservation	60,673,493	74,745,124	14,071,631	23.19%
5801	Department of Revenue	67,225,076	70,260,764	3,035,688	4.52%
6101	Department of Administration	32,899,433	35,367,486	2,468,053	7.50%
6102	Appellate Defender	362,670	377,492	14,822	4.09%
6201	MT Dept of Agriculture	20,451,741	23,934,691	3,482,950	17.03%
6401	Dept of Corrections	201,349,134	216,048,567	14,699,433	7.30%
6501	Department of Commerce	117,272,710	39,683,422	(77,589,288)	-66.16%
6602	Labor & Industry	118,553,598	124,144,991	5,591,393	4.72%
6701	Dept of Military Affairs	20,946,190	35,647,142	14,700,952	70.18%
6901	Public Health & Human Services	1,973,397,909	2,195,582,098	222,184,189	11.26%
Total		\$5,751,024,027	\$6,147,275,335	\$396,251,308	6.89%
Adjusted for OPI Fund Switch		\$5,705,383,410	\$6,147,275,335	\$441,891,925	7.75%

Comparable Adjustments

Employee Pay Proposal	In Above	24,382,307	24,382,307	
Statutory Appropriations	597,226,015	618,692,678	21,466,663	3.59%
Miscellaneous Appropriations	11,731,000	499,150	(11,231,850)	-95.75%
Legislative Session Costs	8,621,661	6,699,000	(1,922,661)	-22.30%
One-Time Only Costs	17,416,133	0	(17,416,133)	-100.00%
Anticipated Reversions	(23,678,000)	(9,370,000)	14,308,000	-60.43%
Total With Comparable Adjustments	\$6,316,700,219	\$6,788,178,470	\$471,478,251	7.46%

Non Comparable Adjustments

Budget Amendments	113,897,969		(113,897,969)	-100.00%
Supplementals	15,685,523		(15,685,523)	-100.00%
Disaster/Emergency Costs	34,528,619	0	(34,528,619)	-100.00%
Total With All Adjustments	\$6,480,812,330	\$6,788,178,470	\$307,366,140	4.74%

* Only the general fund portion is shown. All funds cannot be determined based on existing accounting records.





EXECUTIVE REVENUE PROPOSALS - SUMMARY

HIGHLIGHTS

The Executive Budget relies on a variety of revenue measures, totaling \$115.4 million, to achieve a balanced budget. Although some measures being proposed by the executive would, if enacted, substantially change the tax structure of the state, their impacts are not considered in the overall general fund balance.

Measures used to balance the budget include:

- Fund transfers, including \$93.0 million from the coal severance tax trust
- Accounting changes
- Increased allocations of various tax revenues
- Increased general fund tax revenues.

Some proposals reduce general fund revenue through reallocation of the coal severance tax revenue and funding switches in House Bill 2.

Figure 1 on the next page summarizes the fiscal impact of each executive revenue proposal. The first section of the figure shows the fiscal impacts of the executive proposals based on assumptions adopted by the Revenue and Transportation Interim Committee and contained in House Joint Resolution 2. The second half of the figure shows fiscal impacts used by the executive to balance the Executive Budget.

LFD ISSUE

Based on legislative revenue assumptions contained in House Joint Resolution 2, the executive revenue proposals generate \$2.2 million less revenue over the 2005 biennium. Thus, the executive ending general fund balance is \$2.2 million less.

Figure 1
Executive Revenue Proposals
General Fund

		General Fund Revenue			
	Legislation	Fiscal 2003	Fiscal 2004	Fiscal 2005	Biennium
Legislative Estimate					
State Fund Transfer	LC 1541	\$9,180,000	\$4,300,000	\$3,780,000	\$17,260,000
Extend Revenue Allocations *					
Coal Tax: Long-range Building	LC 1322	0	612,000	573,500	1,185,500
Coal Tax: Shared Account	LC 1322	0	1,092,190	1,023,554	2,115,743
Coal Tax: Parks Acquisition Trust	LC 1323	0	389,000	364,000	753,000
Oil & Gas: Orphan Share Account	LC 1322	0	903,358	887,149	1,790,507
Oil & Gas: Reclam. & Devel. Account	LC 1322	0	903,358	887,149	1,790,507
Metalliferous Mines: Reclam. & Devel. Account	LC 1322	0	358,000	332,000	690,000
Subtotal		0	\$4,257,906	\$4,067,352	\$8,325,257
Oil and Gas Accrual		3,000,000	0	0	3,000,000
Terminate Telecommunications Infrastructure Credit *	LC 933	0	300,000	300,000	600,000
Permanent Coal Severance Tax Trust Transfer	LC 74	0	93,000,000	(6,755,613)	86,244,387
TSEP Reallocation *	LC 1486	0	(120,000)	(360,000)	(480,000)
Revenue Reductions Due to Expenditure Proposals					
DEQ Earmarking of Environmental Penalties	HB 2	0	(150,000)	0	(150,000)
State Auditor Increased in State Special Approp.	HB 2	0	(380,514)	(378,285)	(758,799)
Subtotal		0	(\$530,514)	(\$378,285)	(\$908,799)
Total		<u>\$12,180,000</u>	<u>\$101,207,392</u>	<u>\$653,454</u>	<u>\$114,040,845</u>
Executive Balance Sheet					
State Fund Transfer		\$9,180,000	\$4,300,000	\$3,780,000	\$17,260,000
Extend Revenue Allocations			4,250,000	4,000,000	8,250,000
Oil and Gas Accrual		3,000,000	0	0	3,000,000
Terminate Telecommunications Infrastructure Credit		0	2,000,000	0	2,000,000
Permanent Coal Severance Tax Trust Transfer			93,000,000	(6,720,000)	86,280,000
TSEP Reallocation			(130,000)	(390,000)	(520,000)
Revenue Reductions Due to Expenditure Proposals**		0	(530,514)	(378,285)	(908,799)
Total		<u>\$12,180,000</u>	<u>\$102,889,486</u>	<u>\$291,715</u>	<u>\$115,361,201</u>
Difference to Due to Use of HJR 2 Assumptions		0	(\$1,682,094)	\$361,739	(\$1,320,356)
*Amounts are based on HJR 2 revenue assumptions recommended by the RTIC, not on the executive balance sheet					
** Reductions were not included in the Executive Budget because of an oversight.					

Each of the proposals shown the table above are presented in more detail, along with LFD issues, in the "Executive Revenue and Tax Policy Proposals/Issues" section, beginning on page 75.



EXECUTIVE EXPENDITURE PROPOSALS - SUMMARY

INTRODUCTION

This section discusses the major changes in expenditures in the 2005 biennium proposed by Governor Martz. The purpose of this document is to provide the reader with a summary view of major trends and policies proposed. A detailed discussion of each agency's proposed budget is included in Volumes 3 and 4 of the Legislative Budget Analysis.

The discussion is confined to HB 2, which appropriates over 80 percent of all general fund expended by state government. It does not include a discussion of other major initiatives, such as the state employee pay plan, statutory appropriations, and other non-HB 2 measures to balance the general fund budget.

HIGHLIGHT AND SUMMARY

The Executive Budget increases general fund by \$5.6 million, or less than 1 percent, in the 2005 biennium compared to the 2003 biennium. However, this figure, which includes a large general fund reduction in K-12, is misleading, in that fiscal 2002 includes general fund to support schools that was reclassified as state special revenue and statutorily appropriated by the legislature in the August 2002 Special Session. This funding will still be used to support schools. If this factor were excluded (over \$45 million in fiscal 2002), the results would show a \$51.3 million increase, or 2.3 percent growth.

Figure 1
General Fund Increases by Major Component
2005 Biennium (in Millions)

Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	\$ 1,023.02	\$ (7.54)	-0.7%	-14.7%
Higher Education	273.38	0.38	0.1%	0.7%
Human Services	531.20	5.68	1.1%	11.1%
Corrections	209.86	14.65	7.5%	28.6%
All Other Government Agencies	278.68	38.08	15.8%	74.3%
Total	\$ 2,316.14	\$ 51.25	2.3%	

*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by \$45.641 million. Actual general fund expenditures in fiscal 2002 were \$560.55 million, which would have resulted in a biennial reduction of \$53.18 million.

Figure 2 shows the same information for total funds, again adjusting K-12 education for the reclassification of funds. As shown, growth in total funds above the 2003 biennium is \$441.9 million or 7.7 percent.

Figure 2 Total Funds Increases by Major Component 2005 Biennium (in Millions)					
Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase	
K-12 Education*	\$ 1,284.80	\$ 38.81	3.1%	8.8%	
Higher Education	386.75	(5.21)	-1.3%	-1.2%	
Human Services	2,195.58	222.18	11.3%	50.3%	
Corrections	216.05	14.70	7.3%	3.3%	
All Other Government Agencies	<u>2,064.10</u>	<u>171.41</u>	9.1%	38.8%	
Total	<u>\$ 6,147.28</u>	<u>\$ 441.89</u>	7.7%		
<u>Funding</u>					
General Fund*	\$ 2,316.14	\$ 51.25	2.3%	11.6%	
State Special	949.06	189.45	24.9%	42.9%	
Federal	2,855.85	202.52	7.6%	45.8%	
Capital Projects	1.03	(0.84)	-44.8%	-0.2%	
Proprietary	<u>25.20</u>	<u>(0.48)</u>	-1.9%	-0.1%	
Total	<u>\$ 6,147.28</u>	<u>\$ 441.89</u>	7.7%		
*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by \$45.461 million. Actual general fund expenditures in fiscal 2002 were \$560.55 million, which would have resulted in a biennial reduction of \$53.18 million.					

The 2005 biennium Executive Budget is defined by a series of additions and reductions in varying sizes and impacts among all agencies. The following summarizes the primary factors.

FTE

110.02 total FTE in fiscal 2004 and 56.84 FTE in fiscal 2005 would be added. This total is the net after reductions in a number of agencies totaling 156.87 FTE in fiscal 2004 and 213.00 FTE in fiscal 2005 (page 98). The FTE increases are predominantly funded by non-general fund.

General Fund

After adjustment for the K-12 education interest and income funds, general fund increases by \$51.3 million.

- The increase is dominated by funding to assume costs of the district courts and by population increases in corrections
- While K-12 education shows a slight decrease, total funds proposed by the executive for K-12 education remain constant when all adjustments are taken into account. This maintenance of funding is in spite of a reduction in average number belonging (ANB) and other factors that reduce the budget by a net \$7.9 million (page 69)
- Higher education is essentially held to the 2003 biennium level as adjusted by the Governor under 17-7-140 and the legislature in special session, despite anticipated enrollment increases (page 70)
- The net increase of \$5.7 million in the Department of Public Health and Human Services (DPHHS) is a net result of increases, primarily for Medicaid, foster care, and subsidized adoption caseloads, offset by significant program reductions, primarily in other Medicaid services and mental health (page 70)

Present Law and New Proposals

General fund present law changes are dominated by four factors:

- Increases for statewide present law adjustments, including full funding of personal services (minus vacancy savings), fixed costs, and inflation
- Caseload and enrollment changes
- Assumption of the district courts
- Reductions to continue the Governor's 17-7-140 spending reductions (although maintenance of precise actions taken in fiscal 2003 cannot be assumed)

General fund new proposals are dominated by program reductions to meet general fund balancing goals within individual agencies. Positive new proposals add a total of \$22.2 million general fund, but are dwarfed by reductions of \$86.9 million.

- General fund new proposals that add funding are distinguished by a lack of clear executive policy initiative. Major increases are to replace funding and address caseload increases in foster care, for developmental disabilities services (in part due to a reduction in federal funding), to discontinue POINTS II (although the total funding request would increase), and to provide \$6.0 million for schools.

All funds new proposals decrease by \$0.7 million in fiscal 2004 and \$4.8 million in fiscal 2005. The smaller decrease than general fund primarily reflects additional state (most notably highway state special revenue bonding proceeds) and federal funds available.

Fund Source

The budget once again continues a trend in recent biennia of a growing federal share of the total state budget (page 73). This biennium reverses recent trends by showing a large increase in state special revenue. However, this increase is skewed by the addition of bonding proceeds for Highway 93 that will be repaid by the federal government

Reduction Measures

Service Reductions or Eliminations - Few functions of state government are eliminated or significantly reduced, and these are primarily concentrated in human services programs (page 105). In most cases, the executive has identified a general fund reduction goal, but is nebulous about what precise measures will be taken to achieve this level of expenditure and the potential impact on services. Defined service reductions total \$38.6 million, while miscellaneous and unspecified reductions (excluding the university system) are over \$41 million

- Human services program reductions total over \$35 million
- The executive recommends that the Montana University System (MUS) be maintained at the reduced 2003 biennium level, which is a reduction of over \$25 million general fund from the fiscal 2002 base with enrollment adjustments. (The reduction is about \$40 million when compared to the total present law base.) The executive has not provided the Board of Regents with any guidelines on policy or programmatic changes necessary to operate within the proposed appropriation

Fee Changes – The executive proposes \$2.6 million in additional or new fees (page 106).

Fund Switches – The executive proposes over \$21 million in fund switches, the largest single category of which is refinancing efforts in the Department of Public Health and Human Services. Over \$900,000 of general fund revenues would be reduced (page 109).

ADJUSTMENTS TO THE FISCAL 2002 BASE

Figure 3 shows the major increases and decreases in the Executive Budget from the doubled fiscal 2002 base. This comparison is used to allow for a comparison that more closely resembles the budget decisions facing the legislature in HB 2, which appropriates over 80 percent of the general fund. HB 2 uses the fiscal 2002 base as the foundation for building the 2005 biennium budget. The K-12 interest and income adjustment is made to the doubled base to more accurately reflect actual change.

Major Increases

Statewide Present Law Adjustments - The primary increases made in the Executive Budget are due to statewide present law adjustments, which consist of:

- Annualization of the 2003 biennium pay plan
- Agency payments for certain fixed costs such as insurance
- Inflation
- Vacancy savings, which nets against the other categories of increases

Total statewide present law adjustments include \$21.5 million for personal services costs for just over 245 additional FTE due to assumption of the district courts.

District Court Assumption – Operating costs to assume district courts are included in this category. Because the district courts were assumed in fiscal 2003, no expenses appear in the base year. The total cost of assumption (including costs in the statewide adjustments) in the 2005 biennium is \$18.2 million in fiscal 2004 and \$19.1 million in fiscal 2005. This figure does not include additional funding requested by the executive for administration, equity pay adjustments, or information technology.

Caseload Adjustments – Changes in Medicaid, foster care, and subsidized adoption caseloads, as well as K-12 education ANB, university enrollment, and corrections FTE, are included here. Please note that a portion of this increase is due to replacement of lost federal funds for foster care.

Other Present Law Adjustments – Included in this category are all other present law adjustments, including adjustments for workload changes and other base adjustments.

New Proposals – The executive requests a total of \$17.2 million in positive new proposals.

Major Decreases

The general fund increases are significantly offset by actions to either reduce general fund expenditures or increase revenues.

Service Reductions - Service reductions are reductions for which the service impact is explicit. Major service reductions are discussed in more detail on page 105.

Funding Switches - Funding switches to replace general fund with other funds reduce general fund expenditures by about \$21.1 million. The major funding switches are discussed in more detail beginning on page 109 of this volume. Please note that a reduction in general fund revenue of about \$0.9 million would also result.

Fee Increases - Fee increases are used to replace \$2.7 million general fund. Major fee increases are discussed in more detail beginning on page 106 of this volume.

Unspecified Reductions to the Montana University System - The executive has specified a reduction but not articulated how they would recommend the Board of Regents, which is responsible for implementing the reductions, address the reduced funding.

Other Miscellaneous/Unspecified Reductions – This category includes all other reductions, including those reductions where the executive has not articulated any policy regarding what, if any, functions should be curtailed or eliminated, and the impact.

Figure 3

HB 2 - Major Executive Changes to the Fiscal 2002 Base
2005 Biennium to Doubled Fiscal 2002 Base

Adjustment	Total
Doubled Fiscal 2002 Base	\$ 2,343.24
K-12 Interest and Income Adjustment	(91.28)
Adjusted Doubled Base	\$ 2,251.96
<u>Major Additions</u>	
Statewide Present Law Adjustments*	\$ 64.43
District Court Assumption	15.76
Caseload/Enrollment Changes	38.38
Other New Proposals	17.17
Other Present Law Adjustments	57.22
<u>Major Reductions</u>	
Service Reductions	(38.57)
Funding Switches	(21.07)
Fee Changes	(2.68)
Unspecified MUS Reductions**	(25.42)
Other Miscellaneous/Unspecified Reductions	(41.05)
Total Executive HB 2	<u>\$ 2,316.14</u>

*Includes \$21.5 million for district court assumption

**Represents the net of present law increases and reductions to maintain expenditures at the reduced 2003 biennium level as classified by the executive, with adjustments for caseload. Total reductions from present law, including statewide adjustments and caseload increases, total over \$40 million.

EXECUTIVE PROPOSALS BY PROGRAM AREA

The Governor's proposed budget by program area is shown in the figure below, without the influence of interest and income payments for K-12 education, which would distort the distribution.

As shown, the general fund increases are concentrated in "All Other State Agencies" (\$38.0 million) and corrections (\$14.6 million). This increase in "All Other" is dominated by costs to assume the district courts beginning in fiscal 2003 and in corrections, by increases in corrections populations. The proposal is noteworthy for the lowest increase for human services in many biennia, which is the result of increases in caseload and other costs, substantially offset by reductions in other services, refinancing efforts, and reclassification of certain tobacco revenues from general fund to state special revenue as a result of the passage of I-146. The reduction in K-12 primarily reflects a reduction in ANB.

All funds show significant increases in human services (\$222.2 million), underlining that agency's significant federal support for Medicaid and other programs, and "All Other State Agencies", which includes the Department of Transportation, where \$87.6 million in bonding proceeds are added.

Figure 4 Proposed Executive Budget by Program Area - HB 2 2003 to 2005 Biennia				
--- General Fund ---				
Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	\$ 1,023.02	\$ (7.54)	-0.7%	-14.7%
Higher Education	273.38	0.38	0.1%	0.7%
Human Services	531.20	5.68	1.1%	11.1%
Corrections	209.86	14.65	7.5%	28.6%
All Other Government Agencies	278.68	38.08	15.8%	74.3%
Total	\$ 2,316.14	\$ 51.25	2.3%	
--- Total Funds ---				
Component	Executive Budget	Increase Over 2003	Percent Increase	Percent of Increase
K-12 Education*	\$ 1,284.80	\$ 38.81	3.1%	8.8%
Higher Education	386.75	(5.21)	-1.3%	-1.2%
Human Services	2,195.58	222.18	11.3%	50.3%
Corrections	216.05	14.70	7.3%	3.3%
All Other Government Agencies	2,064.10	171.41	9.1%	38.8%
Total	\$ 6,147.28	\$ 441.89	7.7%	
*The 2003 figure used to compare to the 2005 biennium is adjusted for the change in classification of school trust interest and income to reflect the true change. Fiscal 2002 expenditures were adjusted by \$45.641 million. Actual general fund expenditures in fiscal 2002 were \$560.55 million, which would have resulted in a biennial reduction of \$53.18 million.				

The following graphically illustrates the comparison between the 2003 and 2005 biennium, by program area, for general fund and for total funds.

Figure 5

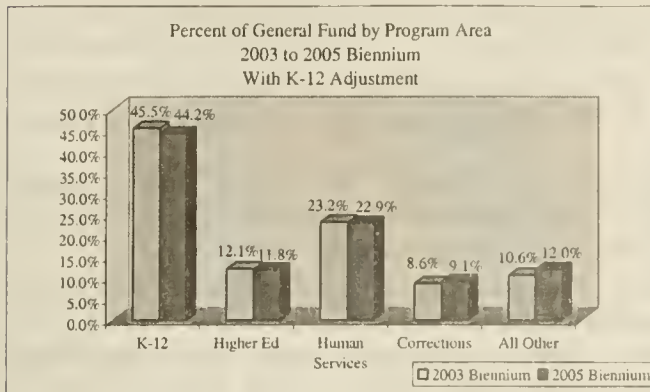
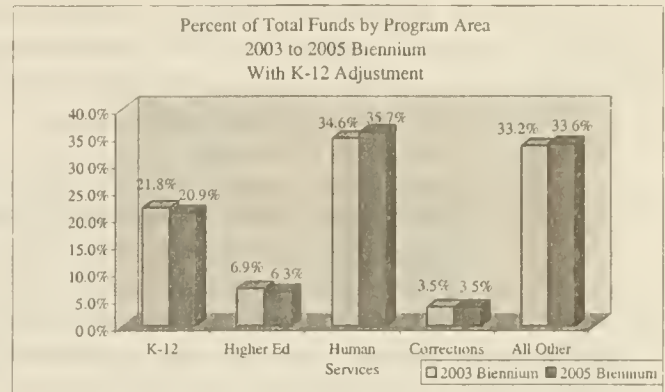


Figure 6



Each of the program areas, along with the Department of Transportation, is discussed in the narrative that follows. Further discussion is included in the individual agency narratives in Volumes 3 and 4.

K-12 EDUCATION

The executive proposes a biennium-to-biennium reduction in total general fund spending for the Office of Public Instruction (OPI), as budgeted in HB 2, of \$53.2 million. However, this gives a misleading picture of the biennial change in the general fund budget for K-12 education. HB 7, passed during the August 2002 special session, removed common school interest and income revenue from the general fund and deposited it in a new state special guarantee fund beginning in fiscal 2003. This money is statutorily appropriated for Base aid to schools and does not appear in HB 2. The amount of this revenue spent on Base aid in fiscal 2002 was \$45.6 million. Thus, the true general fund reduction between biennia is \$7.6 million for the agency, which is the net of a \$7.9 million reduction in the Distribution to Schools Program and a \$0.3 million increase in state level activities. The Distribution to Schools reduction is the net result of:

- Declines in present law ANB
- Allowing averaging of ANB in fiscal 2005
- Increases in entitlements
- Reductions in the direct state aid percent
- Savings in retirement GTB costs
- Using timber revenue to pay for Base aid
- A teacher loan repayment proposal
- Increasing state support for school facility costs

A further biennial comparison of state effort in OPI can be made by comparing all state funds, including state special revenue accounts. During the 2003 biennium, state special account spending will be \$5.1 million for the flex account and drivers education. For the 2005 biennium, the executive proposes the use of state special revenue from diversion of Treasure State Endowment interest revenues for school district facility reimbursements in the amount of \$8.5 million. Thus state special spending in OPI between biennia will increase by \$3.4 million. With the decrease of \$7.6 million in general fund spending, the net change in OPI's budget between the 2005 biennium and the 2003 biennium for all state accounts is a reduction of \$4.2 million.

For a further discussion, see the narrative for the Office of Public Instruction beginning on page E-1 of Volume 4.

HIGHER EDUCATION

The Executive Budget proposes the Montana University System receive approximately the same amount of general fund in the 2005 biennium as was appropriated in fiscal 2002 and fiscal 2003 following special session action, or \$273.4 million. To accomplish this objective, the Executive Budget:

- Eliminates general fund support for all statewide present law adjustments, a biennial total of \$21.2 million
- Eliminates general fund support for all other present law adjustments, including enrollment growth, continuation of the \$100 per resident student authorized by the 2001 legislature, and fee waiver increases. The total biennial reduction is \$16.0 million
- Reduces the proposed general fund budget an additional \$3.8 million (\$0.9 million of this reduction is replaced with six-mill levy revenue)

The Executive Budget proposes that increased tuition revenue from anticipated student enrollment increases and tuition rate increases fund present law and pay plan cost increases at the educational units.

For a further discussion see the narrative for the Office of the Commissioner of Higher Education beginning on page E-91 in Volume 4.

HUMAN SERVICES

The Department of Public Health and Human Services (DPHHS) 2005 biennium budget request grows \$5.7 million general fund and \$222.2 million total funds from the 2003 biennium. The increase in general fund is net after several offsetting reductions. The most significant changes include the following:

- Medicaid caseload changes, eligibility reductions, provider rate reductions, and service limitations and eliminations net to an increase of \$18 million general fund (\$62 million total funds). Significant Medicaid program changes include:
 - Eligibility changes that reduce services or delay eligibility for 511 persons, with nursing home residents impacted most significantly
 - Elimination of hospice services
 - In-home Medicaid therapy services for elderly and physically disabled adults
 - Provider rate reduction of 1.87 percent
- Institutional cost increases add \$8 million general fund
- Foster care and subsidized adoption caseload growth adds \$6 million general fund (\$9 million total funds)
- Funding shifts that reduce general fund and increase other funds by \$15 million and include:
 - \$9 million of tobacco settlement revenue allocated by Initiative 146 that offsets Children's Health Insurance Program, tobacco control, and Medicaid matching costs
 - \$2 million of alcohol tax proceeds formerly allocated to local programs to offset Medicaid mental health match
 - \$1 million of county funds previously paid to community mental health centers for mental health Medicaid match
- Program eliminations and reductions of \$31 million general fund (\$14.6 million total funds). Eliminations include:
 - MIAMI (reduce infant mortality and low-birth weight babies)
 - End state renal disease program
 - Poison control

Reductions include:

- Mental Health Services (\$16 million)
- Childcare funding
- Adult protective services grants
- Aging community services
- In-home services for abused and neglected children
- Refinancing general fund costs in foster care and developmental disability services by increasing the federal share of costs reduces general fund by \$10 million

For a further discussion, see the narrative for the Department of Public Health and Human Services beginning on page B-1 of Volume 3.

DEPARTMENT OF CORRECTIONS

For the 2005 biennium, the department is requesting total funds of \$216.0 million, of which \$209.9 million is general fund. This request represents an increase in total funds of 7.3 percent (7.5 percent general fund) from the 2003 to the 2005 biennia. The majority of the requested increase \$14.7 million is to fund community corrections and adult secure facilities. Annualization of the WATCH DUI Unit and the expansion at Montana Women's Prison accounts for \$8.4 million of the general fund increase.

The average daily population of adult offenders in community corrections and secure facilities is projected to grow approximately 2.7 percent in fiscal 2003 and 3.5 percent each year of the 2005 biennium, or an increase of 948 adult offenders from fiscal 2002 to fiscal 2005. The average daily population of adult offenders in secure facilities is projected to decrease by 3.3 percent in fiscal 2003 and increase approximately 2.4 percent each year of the 2005 biennium, or an increase of 33 adult offenders from fiscal 2002 to fiscal 2005.

For a further discussion, see the narrative for the Department of Corrections beginning on page D-56 of Volume 4.

TRANSPORTATION

The Department of Transportation 2005 biennium budget request is \$132.8 million more than the 2003 biennium expenditures and appropriation. The majority of the increase, \$87.6 million state special revenue, is for bonding proceeds associated with highway revenues bonds to expedite construction activities on Highway 93. The remaining requests that contribute significantly to this increase are:

- Increases for payments to highway construction contractors for the federal-aid and state-funded construction programs
- An increase of federal funds for an information technology project to integrate the financial management systems of the department
- Runway rehabilitation projects at the West Yellowstone and Lincoln airports
- An increase to provide federal transit infrastructure grants to local transit authorities

For a further discussion, see the narrative for the Department of Transportation beginning on page A-93 of Volume 3.

ALL OTHER AGENCIES

As stated above, the general fund increase for all other agencies is dominated by the costs to assume the district courts mandated by SB 176, passed by the 2001 legislature. Courts were assumed in fiscal 2003, so only one year of costs is included in the 2003 biennium. Two other major increases are proposed:

- The Department of Justice would increase \$6.0 million, primarily because the legislature switched funding for the Motor Vehicle Division in fiscal 2003 from general fund to highways state special revenue for one-time-only. The executive proposes to fund the division with general fund in the 2005 biennium
- The Department of Natural Resources and Conservation would increase \$7.6 million due primarily to statewide present law adjustments, and a reduced fiscal 2003 base due to funding switches

The increase in total funds primarily reflects: 1) increases in the Department of Transportation, including \$87.6 million of bonding proceeds; 2) general increases in the Department of Fish, Wildlife, and Parks; and 3) the assumption of district courts. Other increases and partially offsetting decreases are widespread among other agencies.

IMPACT OF GOVERNOR'S PROPOSALS ON INDIVIDUAL AGENCIES

The impact on individual agencies of the Governor's proposals to balance the general fund budget is extremely varied. In addition, while examining the change in general fund from the 2003 biennium or the doubled fiscal 2002 base can be instructive, it may not necessarily provide the entire picture, as the large funding shifts attest. Also, other funds were not decreased proportional to general fund. On the contrary, the policy of the Governor's budget is to access as many stand-alone federal funds as possible, and generally to attempt to meet maintenance of effort requirements.

To illustrate, the following figure shows the total impact of proposed reductions on six agencies.

Figure 7 Illustration of Impact of Reductions 2005 Biennium Executive Budget						
Agency	General Fund Actual Doubled Fiscal 2002 Base*	General Fund Proposed 2005 Biennium	Percent Change	Total Funds Actual Doubled Fiscal 2002 Base	Total Funds Proposed 2005 Biennium	Percent Change
Commissioner of Political Practices	\$ 663,330	\$ 640,438	-3.5%	\$ 663,330	\$ 640,438	-3.5%
Transportation**	0	0	--	865,280,080	1,128,845,704	30.5%
Montana University System	277,178,716	273,375,072	-1.4%	381,239,234	386,748,185	1.4%
Justice	47,294,788	46,306,640	-2.1%	96,237,920	109,062,308	13.3%
Fish, Wildlife, and Parks	563,632	511,867	-9.2%	90,662,162	114,309,086	26.1%
Corrections	193,780,508	209,856,878	8.3%	199,457,280	216,048,567	8.3%
*The doubled base is used to avoid one-time-only fiscal 2003 budget adjustments, such as replacement of general fund with state highways funds in the Motor Vehicle Division.						
**Increase in the 2005 biennium is skewed by the addition of \$87.6 million in bonding proceeds for Highway 93 that will be repaid by the federal government.						

Please note that the provision of additional non-general funds does not necessarily mean maintenance of the same services that may be reduced as a result of reduced general fund. Additional other funds may not be proposed or available for use in the same manner.

EXECUTIVE PROPOSALS BY FUND SOURCE

The following figure shows the change in funding source of state government in HB 2 from the 2003 to the 2005 biennium. The figure reflects the reclassification of interest and income revenues used to support K-12 Education, which otherwise skews the general fund totals from which the percentages are derived. As a comparison, the figure on the right factors out the impact of the interest and income reductions.

Figure 8

Percentage of Total Funds by Fund Source
2003 to 2005 Biennium
Without K-12 Adjustment

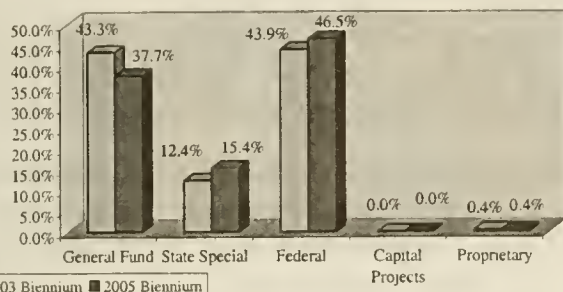
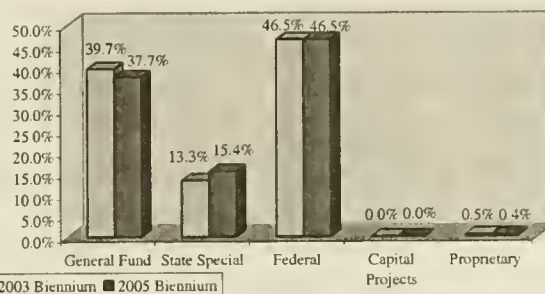


Figure 9

Percentage of Total Funds by Fund Source
2003 to 2005 Biennium
With K-12 Adjustment



GENERAL FUND

General fund continues to be a smaller percentage of the total state budget.

- A portion of the reduction is due to the accounting change that reclassifies about \$45 million in interest and income revenues per year from the general fund to statutorily appropriated state special revenue. In addition, the allocation of some tobacco proceeds from the general fund to state special revenue as a result of the passage of I-146 reclassifies \$9.0 million
- District court assumption and increasing correctional populations dominate the increases. DPHHS caseloads and costs (including institutional costs) are also increasing, but are generally offset with federal and state funds refinancing and program reductions
- K-12 ANB continues to fall, reducing general fund present law adjustments
- The executive does not condition the higher education proposed budget on anticipated student FTE, instead maintaining state support at roughly the reduced 2003 biennium level
- The general fund budget for most agencies is below the adjusted present law level, although the impact differs due to the availability of other funds

STATE SPECIAL REVENUE

State special revenue fund growth as a percentage of the budget is contrary to recent trends, but bonding proceeds and accounting changes skew the growth.

- The figures reflect bonding proceeds of \$87.6 million in the Department of Transportation for Highway 93 that will be repaid by the federal government
- A change in allocation of some tobacco revenues from general fund to state special revenue accounts as a result of the passage of I-146 adds an additional \$9.0 million
- The proposal to use Treasure State Endowment Program (TSEP) funds in the Office of Public Instruction adds \$8.5 million
- True increases include:
- Additional intergovernmental transfer authority from counties in DPHHS

- Additional general license account and other state special revenue appropriations in the Department of Fish, Wildlife, and Parks
- A proposal to increase the current court fee surcharge for information technology in the Judiciary
- Additional highways state special revenue funds for road construction and maintenance
- Use of state special revenue in the Department of Military Affairs from Employment Security Account funds to replace general fund to support the Youth Challenge Program (because the legislature made this program one-time-only, no funds to support the program are included in the 2003 biennium general fund figures)

Federal Funds

Federal funds continue to be a growing part of the state budget

- As stated earlier, the Governor's budget attempts to utilize all available stand-alone federal funds, and generally to attempt to continue to meet maintenance-of-effort requirements. Consequently, the additional federal funds are widely dispersed across state government.
- The federal presence in K-12 education continues to grow. While still only a fraction of total expenditures in this area, federal funds increase by \$38.2 million, or 17.9 percent.
- Increases in federal funds in the Department of Transportation have slowed from the large increases in recent years
- Human services continues to see large increases
- Some of the reductions in DPHHS and the Department of Commerce would result in the loss of federal funds (page 108)
- An accounting change for food stamps adds about \$69.5 million that does not represent a fund increase. This increase is completely offset by the reclassification of House and Urban Development (HUD) funds to an enterprise account, which does not require an appropriation. This reclassification removes over \$80 million in the 2005 biennium.

Impact and Ramifications

The impact and ramifications of increasing federal funds at a time when general fund spending is curtailed can be uncertain. The resulting funding mix could either:

- Signal a greater efficiency in the use of general fund, as with the refinancing efforts in DPHHS, or
- Indicate a shifting from state priorities funded with general fund to federal priorities in order to take advantage of the available funding. This scenario is also evidenced in DPHHS, where a number of programs are being eliminated, but overall funding is increased by over \$150 million (if food stamp impact is not included) due in part to the provision of funding for other federal priorities, such as bioterrorism

In addition, in a time of growing federal deficits, increased reliance on the federal government to maintain programs, or to expand state government programs or services, exposes the state to greater risk and fewer choices if and when federal budget reduction measures are taken.



EXECUTIVE REVENUE AND TAX POLICY PROPOSALS / ISSUES

INTRODUCTION

This section presents a description of the revenue and tax policy proposals of the Governor, plus LFD issues and comments about the proposals. These proposals are listed below and are discussed in more detail in the following pages. The first part discusses the proposals included in the Executive Budget submitted to the legislature on November 15, 2002. The second part discusses briefly the Governor's proposals for tax policy reform that are being submitted outside of the formal Executive Budget.

Proposal	<u>Page</u>
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REVENUE AND TAX POLICY PROPOSALS – EXECUTIVE BUDGET

STATE FUND TRANSFER

The Executive proposes to transfer \$9.2 million to the general fund from the State Fund "old fund" account. The old fund refers to workers compensation claims occurring before July 1, 1990. Statute requires that the fund maintain sufficient monies to cover its full costs, plus a 10 percent contingency. Monies in excess of that are to be transferred to the "new fund". These excess monies exist for a variety of reasons, but primarily because of overestimated claims liability and higher than average investment earnings. Legislation is being proposed that will allow the identified excess to be transferred to the general fund instead. The amount identified as available to transfer as of the end of June 2002 is \$13.2 million, which would be transferred in fiscal 2003. SB 19 of the August special session authorized the transfer of \$4.0 million of those funds to the general fund. The executive identifies additional amounts of \$4.3 million to be transferred in fiscal 2004 and \$3.8 million to be transferred in fiscal 2005. These estimates were provided by the State Fund to the Office of Budget and Program Planning.

EXTEND REVENUE ALLOCATIONS

The executive proposes to extend a number of temporary revenue actions enacted by the legislature in the August 2002 special legislative session to balance the general fund budget. These are: 1) eliminating the transfer of general fund to the Department of Transportation's state special revenue fund; 2) eliminating the transfer of general fund to the Department of Commerce's research and commercialization fund; 3) reducing the general fund statutory appropriation to the Department of Agriculture for the Growth Through Agriculture program; 4) increasing the amount of coal severance tax revenue deposited to the general fund by reducing current allocations in three programs; 5) increasing the amount of metalliferous mines tax revenue deposited to the general fund; and 6) increasing the amount of oil and natural gas production tax revenue deposited to the general fund.

Transfers

House Bill 5 from the August 2002 Special Session reduced the fiscal 2003 general fund transfer to the Department of Transportation state special revenue account from \$2.92 million to \$75,000. The executive proposes (LC 187) to eliminate the transfer for the 2005 biennium for a general fund savings of \$5.97 million.

House Bill 5 from the August 2002 Special Session reduced the fiscal 2003 transfer of general fund to the Department of Commerce's research and commercialization fund from \$4.85 million to \$3.17 million and reduced the annual transfers in the 2005 biennium from \$4.85 million to \$3.65 million. The executive proposes (LC 1322) to eliminate the 2005 biennium transfers for a general fund savings of \$7.30 million. Under current law, this transfer terminates at the end of fiscal 2005.

LFD COMMENT

Although the legislation proposed by the executive eliminates \$7.30 million in general fund transfers over the biennium, the executive general fund balance sheet shows \$7.13 million.

Statutory Appropriations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session reduced the fiscal 2003 general fund statutory appropriation for the Growth Through Agriculture program from \$1.25 million to \$0.93 million. The executive proposes (LC 1322) to reduce the 2005 biennium appropriations for the Growth Through Agriculture program from \$2.50 million to \$1.25 million, a reduction in expenditures of \$1.25 million. Under current law, this statutory appropriation terminates at the end of fiscal 2005.

LFD COMMENT

Economic development has been a high priority for the Martz administration. However, the Executive Budget reduces funding available for agricultural, research, and commercialization economic programs by \$8.55 million* over the 2005 biennium. These programs were enacted and funded by the legislature to stimulate and enhance economic activity within the state.

* The executive general fund balance sheet shows \$8.38 million for these reductions.

Coal Severance Tax Allocations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session changed the fiscal 2003 allocation of coal severance tax revenue for three programs. The allocations for the:

- Long-range building program were reduced from 12 percent to 10 percent with the difference deposited to the general fund. The executive proposes (LC 1322) to reduce the 2005 biennium allocations from 12 percent to 10 percent for a \$1.19 million increase in general fund revenue.
- Shared allocations were reduced from 8.36 percent to 6.01 percent with the difference deposited to the general fund. The executive proposes (LC 1322) to reduce the 2005 biennium allocations from 7.75 percent to 4.18 percent, for a \$2.12 million increase in general fund revenue.
- Parks acquisition trust fund of 1.27 percent was diverted to the general fund. The executive proposes (LC 1322) to eliminate the 2005 biennium allocations for a \$0.75 million increase in general fund revenue.

LFD COMMENT

House Bill 10 from the August 2002 Special Session eliminated the 0.63 percent fiscal 2003 allocation of coal severance tax revenue to the cultural trust and also eliminated the annual \$0.43 million statutory appropriation for certified communities in fiscal 2003. The executive proposal does not continue these eliminations into the 2005 biennium as is done with other changes enacted by House Bill 10. Including these eliminations would increase the ending general fund balance by \$1.22 million.

The legislature reduced the shared coal severance tax allocation to 6.01 percent for fiscal 2003 and allocated 7.75 percent for the 2005 biennium. The executive proposes to reduce the allocation in the 2005 biennium to 4.18 percent.

Oil and Natural Gas Production Tax Allocations

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session eliminated the fiscal 2003 distribution of oil and natural gas revenue to the orphan share account and the reclamation and development grants account and increased the amount deposited to the general fund. The executive proposes (LC 1322) to eliminate these allocations in the 2005 biennium for a \$3.58 million increase in general fund revenue.

Metalliferous Mines Tax Allocation

Among other reductions and eliminations, House Bill 10 from the August 2003 Special Session eliminated the fiscal 2003 distribution of metalliferous mines tax revenue to the reclamation and development grants account and increased the amount deposited to the general fund. The executive proposes (LC 1322) to eliminate this allocation in the 2005 biennium for a \$0.69 million increase in general fund revenue.

Figure 1 shows the combined general fund impacts of proposed reductions in disbursements and increased revenue from proposed changes to tax allocations.

Figure 1
Reduced Disbursements and Increased Revenue
Proposed Executive Legislation
General Fund

Tax/Program	Legislation	General Fund Savings/Revenue		
		Fiscal 2004	Fiscal 2005	Biennium
Transfers (reduced disbursements)				
Department of Transportation	LC 187	\$2,960,715	\$3,005,126	\$5,965,841
Research & Commercialization *	LC 1322	<u>3,650,000</u>	<u>3,650,000</u>	<u>7,300,000</u>
Executive Balance Sheet		3,565,000	3,565,000	7,130,000
Subtotal		\$6,610,715	\$6,655,126	\$13,265,841
Statutory Appropriation (reduced appropriations)				
Growth Through Agriculture	LC 1322	<u>\$625,000</u>	<u>\$625,000</u>	<u>\$1,250,000</u>
Subtotal		\$625,000	\$625,000	\$1,250,000
Tax Allocations ** (increased revenue)				
Coal Tax: Long-range Building	LC 1322	\$612,000	\$573,500	\$1,185,500
Coal Tax: Shared Account	LC 1322	1,092,190	1,023,554	2,115,743
Coal Tax: Parks Acquisition Trust	LC 1323	389,000	364,000	753,000
Oil & Gas: Orphan Share Account	LC 1322	903,358	887,149	1,790,507
Oil & Gas: Reclam. & Devel. Account	LC 1322	903,358	887,149	1,790,507
Metalliferous Mines: Reclam. & Devel. Account	LC 1322	<u>358,000</u>	<u>332,000</u>	<u>690,000</u>
Subtotal		\$4,257,906	\$4,067,352	\$8,325,257
Executive Balance Sheet		4,250,000	4,000,000	8,250,000
Total		<u>\$11,493,621</u>	<u>\$11,347,477</u>	<u>\$22,841,098</u>

Executive balance sheet amounts are not reflected in totals.

* The amounts are consistent with the proposed legislation, not with the executive general fund balance sheet.

** Revenue changes are based on HJR 2 revenue assumptions recommended by the RTIC, not on the executive balance sheet.

OIL AND NATURAL GAS ACCRUAL

Under current law, the state collects all oil and natural gas production taxes 60 days after the end of each calendar quarter. The state has an additional 60 days to distribute the local share to counties. Within 30 days, counties' allocate the revenue to local jurisdictions and to the state's 95 and 6 mill levy account. Under current law, the state does not accrue year-end receivables for the 95 and 6 mill share of oil and gas receipts.

The executive proposal is for the state to retain the 95 and 6 mill share of oil and natural gas receipts, instead of remitting the money to the counties and waiting 90 days for the return of the state's share. The state would be able to accrue this portion at the end of the fiscal year, resulting in a one-time increase in oil and natural gas production tax revenues of \$3 million in fiscal 2003.

The proposal would eliminate the distribution of oil and natural gas production taxes across mill levies. Instead, these revenues would also be distributed to counties, school districts, and the countywide education accounts on the basis of fixed shares. The fixed shares in each jurisdiction would be based on the ratio of historical average of receipts in the jurisdiction to all receipts in the county in which the jurisdiction is located.

TELECOMMUNICATIONS INFRASTRUCTURE CREDIT

The executive proposes to terminate the telecommunications credit for investments in telecommunications infrastructure. The 2001 legislature in SB 494 temporarily suspended the credit during the 2003 biennium. Under present law the credit will be restored in fiscal 2004 and then terminate June 30, 2004. The executive proposal would terminate the credit as of July 1, 2003.

LFD ISSUE

The executive estimates that the credit will increase general fund revenues by \$2 million in fiscal 2004. The maximum allowable credit for all firms combined is \$2 million per year. However, the estimate that was adopted by the Revenue and Transportation Interim Committee in November 2002 for the telecommunications infrastructure credit for 2005 biennium was \$0.6 million. Actual credits claimed during the two years of the 2001 biennium were just under \$0.6 million.

COAL SEVERANCE TAX TRUST TRANSFER

Executive Proposal

To maintain a balanced budget through the 2005 biennium, the executive relies on a \$93.0 million transfer from the principal of the coal severance tax trust fund to the general fund at the end of fiscal 2004 (House Bill 74). The executive estimates an interest earnings loss of \$6.72 million during fiscal 2005 from the trust, which is a loss of general fund revenue. However, the executive proposal is silent on the details of the transaction, other potential fiscal impacts, and other implications of liquidating \$93.0 million of trust investments. In addition, the executive proposes legislation to deposit any unanticipated increase in the general fund ending balance to the trust until the \$93.0 million is replaced (House Bill 74). The following discussion and analysis address these issues.

Constitutional Considerations

Article IX, Section 5 of the Montana Constitution, in part, addresses when the principal of the trust can be appropriated or transferred:

"The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature."

The legislature has appropriated trust principal in the past. Examples include:

- 2001 session - \$75,000,000 loaned to the Department of Natural Resources and Conservation to buy mineral production rights from the common school trust (Senate Bill 495)
- 2001 session - \$990,000 loaned to the Department of Justice to fund the natural resource damage and litigation program (House Bill 444)
- 2001 session - pledged to pay debt service for \$18,856,102 in bonds, the proceeds from which are loaned for renewable resource projects (House Bill 8)
- 1999 session - \$1,650,000 loaned to the Department of Justice to fund the natural resource damage and litigation program (House Bill 92)
- 1999 session - pledged to pay debt service for \$22,897,465 in bonds, the proceeds from which are loaned for renewable resource projects (House Bill 8)
- 1995 session - \$3,250,000 for the microbusiness finance program (HB 354)
- 1995 session - \$2,359,857 loaned to the Department of Justice to fund the natural resource damage and litigation program (HB 305)

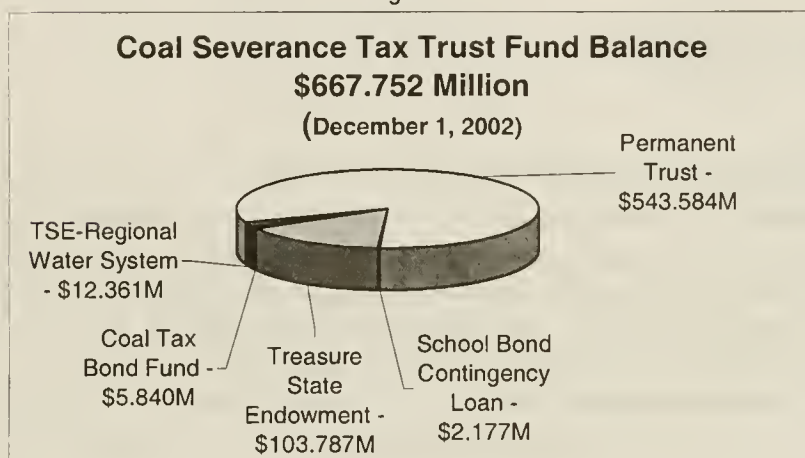
- 1993 session – \$7,794,105 loaned to the Department of Health and Environmental Sciences to fund the natural resource damage and litigation program (HB 401)
- 1991 session - \$3,250,000 for the microbusiness finance program (House Bill 477)

Loans that are written down or written off result in a loss of the trust fund principal. For example, in fiscal 2002, write-offs for five Montana Science and Technology Alliance loans (the 1997 legislature abolished this program) and one participation loan resulted in a principal loss of \$1,794,968.

The coal severance tax trust fund receives 50 percent of total coal tax collections according to Article IX, Section 5 that states:

"The legislature shall dedicate not less than one-fourth (1/4) of the coal severance tax to a trust fund, the interest and income from which may be appropriated. The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature. After December 31, 1979, at least fifty percent (50%) of the severance tax shall be dedicated to the trust fund."

Figure 2



The money flows through five sub-trust funds within the trust. The combined fund balances of these sub-trusts as of December 1, 2002 was \$667,752,380 (Figure 2).

In order, these trusts and an explanation of each are:

1. Coal Tax Bond Fund (Title 17, Chapter 5, Part 7) – The legislature authorizes the sale of coal severance tax bonds to finance renewable resource projects (Title 85, Chapter 1, Part 6) and local government

infrastructure projects (Title 90, Chapter 6, Part 7). A maximum of \$250 million in bonds is authorized as loans for renewable resource projects (17-5-719, MCA) to provide:

- a healthy economy;
- alleviation of social and economic impacts created by coal development; and
- a clean and healthful environment.

The total amount of outstanding principal of renewable resource bonds at any time cannot exceed \$20 million (85-1-624, MCA). An amount equal to the following year's principal and interest payments is maintained in the fund. Money in the fund is pledged to pay the debt service on the bonds if interest and principal payments by the loan recipients are insufficient to fully pay the debt service. Bonds are authorized, projects approved, loan rates established, and bond proceeds are appropriated by the legislature to the Department of Natural Resources in House Bill 8.

2. School Bond Contingency Loan Fund – In the January 1992 Special Session, the legislature created this fund and provided for \$25 million of school district bonds to be secured by loans from the fund (20-9-466 & 467, MCA). An amount is maintained in the fund equal to the following year's principal and interest payments of loans secured by the fund. All outstanding loans will be retired in 2012.
3. Treasure State Endowment Fund – In June 1992, the voters approved a legislative referendum establishing the treasure state endowment program. Initially funded with \$10 million from the

permanent fund, the fund receives 75 percent (37.5 percent of the total) of the remaining coal severance tax money after deposits (if any) to the coal tax bond fund and the school bond contingency loan fund through the 2003 biennium. From then forward, the fund will receive 50 percent (25 percent of the total). Projects are approved and interest earnings from the fund are appropriated to the Department of Commerce by the legislature in House Bill 11 as grants for local government infrastructure projects.

4. **Treasure State Endowment Regional Water System Fund** – The 1999 legislature established the treasure state endowment program to fund regional water system projects. The fund receives 25 percent (12.5 percent of the total) of the remaining coal severance tax money after deposits (if any) in the coal tax bond fund and the school bond contingency loan fund. Projects are restricted to drinking water systems that provide water for domestic, industrial, and stockwater use for communities and rural residences that lie in specific northcentral and northeastern geographic areas. Projects are approved and interest earnings from the fund are appropriated to the Department of Commerce by the legislature in House Bill 11 as grants for local government infrastructure projects. Originally scheduled to sunset at the end of fiscal 2013, the 2001 legislature approved House Bill 40 that extends the program through fiscal 2016.
5. **Permanent Fund** – Prior to the establishment of the previous four funds, all the coal severance tax allocated to the trust fund was deposited to the permanent fund. From fiscal 2000 through fiscal 2003, the permanent fund does not receive any deposits of coal severance tax. Beginning fiscal 2004, the fund receives 25 percent of the remaining coal severance tax money after deposits (if any) in the coal tax bond fund and the school bond contingency loan fund. Interest earnings from the fund are deposited to the general fund (17-5-704, MCA). These earnings are equivalent to approximately a 23 mill statewide levy or a 7.0 percent individual income tax surtax. General fund is appropriated in the general appropriation act (House Bill 2), in statute (statutory appropriations), or in other pieces of legislation (cat and dog bills).

Availability

Money in the coal severance tax trust fund is held by the Board of Investments in three basic types of investments: 1) bonds; 2) loans; and 3) cash or cash equivalents.

Bonds in the trust, consisting of U.S. government-backed bonds and corporate bonds, comprise a portion of the state's trust fund bond pool (TFBP) that contains investments from 11 other participating funds in addition to the permanent fund, school bond contingency bond fund, treasure state endowment fund, and TSE regional water system fund. At the end of fiscal 2002, investments in the TFBP comprised 61 percent or \$403 million of the coal severance tax trust fund balance. The trust provides loans to entities for a number of different programs and purposes:

- Commercial loans
- Department of Natural Resources and Conservation for the purchase of school trust mineral production rights
- Montana Science and Technology Alliance (although the program was eliminated, some loans are still outstanding)
- Infrastructure
- Value added
- Department of Justice to fund the state's natural resource damage and litigation efforts; and
- Montana Facility Finance Authority

At the end of fiscal 2002, these investments comprised 35 percent, or \$232 million of the coal severance tax trust fund balance. Cash or cash equivalents are investments in the state's short-term investment pool (STIP) when the money is in-between being invested in either the TFBP or loans. At the end of fiscal 2002, these investments comprised 4 percent, or \$26 million of the coal severance tax trust fund balance.

If the legislature decides to implement the executive proposal or one of its own that requires a large sum of money to be transferred out of the trust, the amount and availability of funds must be determined. Money invested in the TFBP or STIP is mostly liquid and can be converted to available cash by the Board of Investments relatively easily. However, the loan portfolio is not liquid and could not be relied upon to provide the cash needed to address a budget shortfall. Since the amount of money in the TFBP and STIP exceeds the \$93.0 million needed to implement the executive proposal, there does not appear to be a problem with the availability of money. However, the Board of Investments is continually adjusting the portfolios and, in recent years, has been moving more money from the TFBP into the loan programs, thus lessening the liquidity of the trust. There is, therefore, a question of compliance with statute if a large sum of money is transferred out of the trust. Section 17-6-305, MCA, states:

"17-6-305. Investment of up to twenty-five percent of coal tax trust fund in Montana economy -- report by board. (1) Subject to the provisions of 17-6-201(1), the board shall endeavor to invest up to 25% of the permanent coal tax trust fund established in 17-6-203(6) in the Montana economy, with special emphasis on investments in new or expanding locally owned enterprises. Investments made pursuant to this section do not include investments made pursuant to 17-6-309(2). For purposes of calculating the 25% of the permanent coal tax trust fund, the board shall include all funds listed in 17-5-703(1). The portion of the permanent coal tax trust fund contained in portfolios formerly administered by the Montana board of science and technology development is included in the 25% of the trust fund allocated to the board for in-state investment under this section.

(2) In determining the probable income to be derived from investment of this revenue, the long-term benefit to the Montana economy must be considered.

(3) The legislature may provide additional procedures to implement this section.

(4) The board shall include a report on the investments made under this section as a part of the information required by 17-7-111." (emphasis added)

LFD ISSUE

If the investment of up to 25 percent of the coal tax trust is not a cap, but merely a target for the Board of Investments to invest as in-state loans, then there is no issue in complying with this statute by transferring a large sum of money out of the trust. If the statute establishes a cap that the Board of Investments cannot exceed, removing a large sum of money from the trust would increase the in-state loan percent and could jeopardize the loan programs. At the end of fiscal 2002, the in-state loan amount invested was 24.97 percent. Transferring \$93.0 million out of the trust would cause the amount invested to exceed 25 percent.

Fiscal Impact

If the legislature transfers \$93.0 million out of the trust, the following need to be considered:

- The amount of the reduction in trust earnings and the corresponding loss of general fund revenue in fiscal 2005 based on revenue assumptions contained in House Joint Resolution 2 (HJR 2);
- the time requirements of the Board of Investments to liquidate the required amount of investments and the additional general fund revenue loss in fiscal 2004 due to this liquidation;
- impacts of potential gains or losses from the liquidation of \$93.0 million in bonds; and
- other considerations.

Based on revenue assumptions contained in HJR 2, it is estimated that the transfer of \$93.0 million from the trust would result in general fund revenue loss of \$6.8 million in fiscal 2005 and a similar amount each year thereafter, assuming that none of the \$93.0 million is returned to the trust.

The Board of Investments can quickly liquidate enough bonds in the TFBP to acquire \$93.0 million in cash by June 29, 2004, the date of transfer specified in the House Bill 74. However, the fiscal impacts depend on the timing of the liquidation, the market conditions at the time of the liquidation, and how it is structured. These items are discussed below.

Timing: If the liquidation occurred at the beginning of fiscal 2004, the money would be invested in STIP for a full year at an interest rate lower than it would have received in the TFBP. This would result in a loss of approximately \$3.5 million in earnings. The loss would be progressively less the closer to June 29, 2004 the liquidation occurred.

Market Conditions: To obtain the \$93.0 million in cash, \$93.0 million of bonds must be liquidated. The value of the bonds depends on the market value at the time they are sold. The market value depends on the prevailing interest rate - if interest rates increase, the value of the bonds decrease. Board of Investment staff feel that it is likely interest rates will increase in the next 1.5 years, thus decreasing the market value of the bonds. If the bonds are sold within the next 1.5 years, the risk for substantial losses is high.

Figure 3 Funds Owning TFBP Shares Fiscal 2002	
Fund	Percent of Total
TRUST AND LEGACY	35.80%
PERM COAL TRUST	27.36%
UCFRB RESTORATION	10.16%
RESOURCE INDEMNITY	8.84%
TREASURE STATE ENDOWMENT	6.82%
STREAMSIDE TAILINGS	4.21%
TOBACCO TRUST	1.95%
COAL TAX PARK ACQUISITION	1.35%
UPPER CLARK FORK COST RECOVERY	1.07%
TREASURE STATE REGIONAL WATER	0.89%
MT POLE SUPERFUND	0.83%
CULTURAL TRUST	0.38%
SCHOOL BOND LOAN	0.18%
UM ENDOWMENT	0.16%
BOI DEFERRED COMP	0.00%
	100.00%

Structure: Since all 15 funds that own shares in the TFBP own a portion of all bonds in the pool, if the liquidation were structured by selling units in the pool (and the underlying securities), all 15 funds would share in the losses (or in the more improbable scenario, the gains). Figure 3 shows the funds that owned shares in the TFBP at the end of fiscal 2002. Another possibility of structuring the liquidation suggested by the Board of Investments would be to transfer \$93.0 million out of the TFBP into the ownership of the permanent fund. The permanent fund would then be liable for all losses incurred from the liquidation. Since all losses would be realized as a reduction in earnings, the earnings from the permanent fund would be reduced with a corresponding decrease in general fund revenue.

Other potential impacts of transferring \$93.0 million out of the coal trust need to be considered. Bond rating companies look at the balance in the trust as one measure of the state's credit worthiness. Although not the only criteria used to rate the state's bonds, a \$93.0 million decrease in the trust balance will not be viewed favorably. The loan programs may be adversely affected by the transfer. If the \$93.0 million were transferred out of the trust, the liquid portion of the trust would be reduced substantially. At the same time, the potential for future transfers out increases. Board of Investment staff state that, as prudent managers, they would need to increase the liquidity of the trust in the event additional transfers were required. To achieve the added liquidity, the loan program would be reduced and more bonds purchased.

Figure 4
Fiscal Impacts of Transferring \$93.0 Million out of the Coal Trust
General Fund

Item	Fiscal 2004	Fiscal 2005	Total
Earning Loss from Liquidation	\$0	(\$6,755,613)	(\$6,755,613)
Maximum Loss - TFBP to STIP	(3,453,648)	0	(3,453,648)
Loss/Gain from Bond Liquidation	Unknown	Unknown	Unknown
Bond Rating Change	Unknown	Unknown	Unknown
Smaller Loan Programs	Unknown	Unknown	Unknown
Total	(\$3,453,648)	(\$6,755,613)	(\$10,209,261)

A summary of the potential fiscal impacts of transferring \$93.0 million out of the trust is shown in Figure 4.

The executive also proposes legislation to transfer any unanticipated increase in the general fund balance from the general fund to the trust until the \$93.0 million is replaced. House Bill 74 defines this yearly amount, beginning fiscal 2005, as the positive difference between the balance reported in the

comprehensive annual financial report and the balance contained in the most recent revenue estimating resolution adopted by the legislature. Although difficult to accurately estimate what these amounts may be, if no transfers occur, the general fund will continue to lose approximately \$6.8 million in coal trust interest earnings revenue each fiscal year.

LFD ISSUE

To determine if any excess general fund balance exists at the end of a fiscal year, House Bill 74 references "the projected ending general fund balance contained in the most recent revenue estimating resolution adopted by the legislature". However, the revenue estimating resolution does not contain a projected ending general fund balance for each year of the upcoming biennium. The final projected ending general fund balances for the upcoming biennium are determined by the Legislative Fiscal Division after the session. These projections are based on legislative appropriations, official revenue estimates, and determination of the final fiscal impacts of enacted legislation. In the case of veto overrides, the final fiscal impacts of approved legislation may not be known for up to 50 days after the end of a session.

One possible alternative to consider would be to amend House Bill 74 to reference the projected ending general fund balances as shown in the most recent Legislative Fiscal Division's fiscal report. However, this also has problems. Since some appropriations continue into the second year of a biennium, transferring the excess fund balance based on this methodology from the first year of the biennium would deplete general fund monies needed to cover legislative authorized biennial appropriations. In addition, this method may not capture the effects of appropriations transferred from the second year of the biennium to the first.

If enacted in such a way that the excess ending general fund balance can be accurately determined, the excess fund balance will not be available as a cushion for unforeseen circumstances in future fiscal years. Recently, fund balances larger than anticipated have been available for the next legislature. Since the growth in the ending fund balance would be stagnant, the legislature would be guaranteed that there would be no additional funds for future biennia until the trust is repaid.

**LFD
ISSUE**

The executive proposal to transfer \$93.0 million from the coal trust to the general fund also contains a provision in House Bill 74 for implementing a payback mechanism. Although the mechanism does not guarantee a specific amount, it remains in effect until the \$93.0 million is paid back. However, because the proposed legislation does not provide for a contractual agreement, the transfer is not considered a loan and, therefore, there is no legal obligation for the \$93.0 million to be repaid if the statute were repealed. To ensure that the coal trust transfer is repaid, the legislature would need to amend House Bill 74 to include language stipulating that the \$93.0 million transfer is a loan and that a contract is required, similar to language in LC 132. This legislation provides a loan of \$650,000 from the coal trust for the state's natural resource damage assessment and litigation efforts and requires a contract between the Board of Investments and the Department of Justice.

TREASURE STATE ENDOWMENT PROGRAM

The executive proposes significant ongoing changes to the Treasure State Endowment Program (TSEP) in the 2005 and future biennia. Under the proposal, \$8.4 million of earnings from the treasure state endowment trust fund will be diverted away from local government infrastructure projects to fund K-12 school facility payments (see page F-6 for any discussion and analysis of the executive's proposals). To partially recover this diverted interest revenue, the executive proposes to increase the coal severance tax allocation to the treasure state endowment trust fund from 25.0 percent of total coal severance tax collections to 37.5 percent. To do this, the 12.5 percent allocation (\$7.0 million over the biennium) to the permanent coal severance tax trust fund would be eliminated. Since earnings from the permanent coal severance tax trust fund are deposited to the general fund, general fund revenue would be reduced. Based on revenue assumptions contained in HJR 2, the loss of general fund revenue would be \$120,000 in fiscal 2004 and \$360,000 in fiscal 2005, and will increase over time.

REVENUE REDUCTIONS

As new proposals, the executive is proposing funding switches that reduce general fund revenue. One funding switch requires legislation to earmark revenue currently deposited to the general fund and the other is implemented based on legislative appropriations. These proposals are:

- Department of Environmental Quality, Central Management Division – Over the biennium, \$150,000 in new state special revenue funding is requested for legal contingencies and database development. The source of the revenue is from various environmental penalties that are currently deposited in the general fund. The executive is proposing legislation (LC 1406) to earmark the penalties (see the LFD Comment below), thus reducing general fund revenue. Although the increased state special revenue authority is in the Executive Budget, the executive general fund revenue estimates do not include the revenue reduction.
- Office of the State Auditor, Securities Program – The proposal is to reduce 2005 biennium general fund appropriations by \$758,799, and increase state special revenue appropriations derived from portfolio notice filing fees by the same amount. Since unspent revenue in the state special revenue fund is transferred to the general fund, this proposal would also reduce general fund revenue by \$758,799 over the biennium. The executive general fund revenue estimates do not include this reduction in revenue.

**LFD
ISSUE**

The legislature has established principles for earmarked revenue (also termed dedicated revenue) in statute in an attempt to avoid unnecessary use of earmarked revenue (17-1-507,MCA). The principles are useful to determine if a particular revenue source should or should not be earmarked. This section reads in part:

“(1) It is the policy of the legislature that a revenue source not be dedicated for a specific purpose unless one or more of the following conditions are met:

(a) The person or entity paying the tax, fee, or assessment is the direct beneficiary of the specific activity that is funded by the tax, fee, or assessment; the entire cost of the activity is paid by the beneficiary; and the tax, fee, or assessment paid is commensurate with the cost of the activity, including reasonable administrative costs.

(b) There is an expectation that funds donated by a person or entity will be used for a specified purpose. Grants from private or public entities are considered donations under this subsection.

(c) There is a legal basis for the revenue dedication. A legal basis is a constitutional mandate, federal mandate, or statutory requirement in which a source of funds is designated for a specific purpose.

(d) There is a recognized need for accountability through a separation of funding from the general fund consistent with generally accepted accounting principles.

(2) The total funding for a program is a legislative budget and policy issue for which a dedicated revenue provision may not be justified if:

(a) a general fund appropriation is needed to supplement the dedicated revenue support for the program or activity; or

(b) dedicating a revenue source or portion of a revenue source diverts funds that could be considered a general revenue source.”

Based on 2(b) above, it does not appear that the proposed earmarking of penalties in the Department of Environmental Quality is justified, since by statutory definition “general revenue source” includes fines. Likewise, the funding switch proposed for the Office of the State Auditor does not appear to be justified under 1(a) above because most of the portfolio notice filing fee revenue (\$2.2 million out of \$2.5 million in fiscal 2002) is transferred to the general fund, and is not used for the benefit of those paying the fees. Instead of approving the proposal, the legislature may want to consider replacing all appropriations from the state special revenue fund with general fund appropriations. This would have no impact of the general fund balance since general fund revenue will increase by the same amount.

TAX POLICY NOT INCLUDED IN THE GOVERNOR’S BUDGET

In May 2002, the Governor announced the formation of three advisory committees to provide recommendations on possible revenue neutral changes to Montana’s tax policy. The three committees were: 1) an income tax advisory council; 2) a tourist tax advisory council; and 3) a local option tax advisory council. Each council finished their work by November 2002.

The recommendations of the income tax advisory council were to:

- Cut income taxes by 10 percent,
- Create 7 tax brackets with a top marginal tax rate of 6.9 percent,
- Limit the deductibility of federal taxes paid to \$5,000, (\$10,000 for married joint returns),
- Create a nonrefundable tax credit for 1 percent of capital gain realizations, thereby reducing the top effective marginal tax rate on capital gains to 5.9 percent.

The income tax proposal is expected to reduce individual income tax revenues by \$55 million per year.

The tourist tax advisory council made the following recommendations

- Where practical, tax sales of goods and services; where impractical, tax gross receipts
- The tax base should include prepared food, alcohol sold by the drink, accommodations, rentals of cars and recreational equipment, guided recreation, admissions to events, recreation fees, and souvenirs
- The tax rate should be sufficient to offset the revenue loss associated with the income tax proposal
- The vendor allowance should be 5 percent, with a maximum amount of \$1,000 per quarter
- The tax rate should be the same for all products and be the same for the entire year
- The tax should be called something other than a tourist tax

The tourist advisory council recommended a 3.32 percent tax rate, with a 5 percent vendor allowance. It was estimated that tax would generate \$55 million in tax revenues and that 46 percent of the tax would be paid by nonresidents. The net tax reduction for Montana residents for both the individual income and tourist tax plan was estimated to be \$9 million per year, after accounting for reduced state income tax liability, increased tourist tax liability, and increased federal income tax liability.

On December 10, 2002, in an overview of the plan, the Governor recommended a 4 percent sales tax, with an individual income tax reduction large enough to consume the additional sales tax revenues.

The local option advisory council made the following recommendations:

- 3 percent local option tax on the same items as the tourist tax, dependent on voter approval
- 30 percent of the revenues from the tax to be shared with counties and cities within the economic region
- At least 10 percent of the tax proceeds to be used for property tax relief
- Local option tax would be administered by the state

**LFD
ISSUE**

The executive does not include any administrative costs for any of the proposed tax or changes in their budget for the 2005 biennium. The estimated costs associated with the tourist tax are estimated to be \$2 million per year. The administrative costs associated with the other proposals are unknown.



STATEWIDE EXECUTIVE BUDGET PROPOSALS / ISSUES

INTRODUCTION/HIGHLIGHTS

INTRODUCTION

This section discusses several stand-alone features of the Executive Budget that either do not pertain to any one agency, or which impact several agencies. These proposals are listed below and discussed in more detail in the following pages.

HIGHLIGHTS

- **Supplemental Appropriations – Fiscal 2003.** The executive's preliminary fiscal 2003 supplemental recommendation totals \$14.5 million general fund, with the largest being a \$9.1 million supplemental appropriation for fire suppression costs.
- **Executive Pay Plan.** The executive includes no pay increase, although she is proposing a \$19.9 million (\$8.5 million general fund) increase for health insurance contributions for state employees in the 2005 biennium to help keep pace with rising costs.
- **FTE.** Total FTE would increase by 110.02 in fiscal 2004 and 56.84 in fiscal 2005 over the fiscal 2002 level. However, these increases are the net of a number of proposed increases (primarily non-general fund) and decreases (primarily general fund) in FTE.
- **Broadbanding.** A sizable number of state employee positions have migrated to the "broadband" classification system, raising questions concerning the potential fiscal impact as agencies apply the increased flexibilities related to pay in a more market-based system.
- **Vacancy Savings.** The executive has applied a 4 percent vacancy savings rate to all personal services including insurance contributions. Vacancy savings reductions total \$47.2 million over the 2005 biennium, of which about \$20.5 million would come from the general fund.
- **Service Reduction.** The executive is proposing known service reductions totaling \$38.6 million general fund from the fiscal 2002 base expenditures.
- **Fee Changes.** The Executive Budget proposal includes changes in fees in various agencies, with the effect of reducing general fund expenditures and increasing expenditures from other funds. The reduction in general fund is estimated to be \$2.7 million with an increase in other funds of \$13.7 million.
- **Reduced Federal Funds.** General fund reductions of \$23.2 million in the executive proposal translate into a federal fund reduction of \$45.5 million.
- **Fund Switches.** Funding switches totaling \$21.1 million (general fund reduction) are included in the Executive Budget proposal.
- **Governor's Economic Development Program.** Although a priority of the Martz administration, economic development budgets shrink in the 2005 budget.

- **Fixed Costs.** In each agency budget, fixed costs refer to costs for services from several programs within state government that provide services to other functions of state government, for which they charge a fee. Fixed costs increase by over \$14 million in the 2005 biennium.
- **Inflation/Deflation.** Applying inflation to only selected expenditure categories and underestimating others does not maintain the same level of buying power for state agencies as fiscal 2002 and, therefore, the statutory present law is not maintained.
- **Long-Range Planning Proposals.** The Governor's request for Long-Range Planning includes a total of \$75.5 million for grants, loans, and capital projects, including environmental cleanup in the Libby and Troy areas.

SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are used to increase existing spending authority for a fiscal year. The supplemental appropriations requested by the executive are for additional funding applicable to the current year, fiscal 2003. The original budget for fiscal 2003 was approved by the 2001 legislature.

There can be two components to a supplemental appropriation request:

- Costs in the current year in excess of appropriations
- A request to replace funding if a transfer of appropriation authority was made from the second year of the biennium (current year) to the first year to address funding shortfalls in that year

The executive's preliminary supplemental recommendation consists of both types of components.

Figure 1
General Fund Supplementals
1987 to 2003 Biennia

Biennium	Millions
1987	\$ 32.7
1989	17.1
1991	20.4
1993	82.2
1995	19.9
1997	14.2
1999	11.5
2001	68.2
2003*	14.5

*HB 3 and HB 16. *Does not include \$1.2 million included as a contingency in the Executive Budget general fund balance sheet.

Figure 1 shows supplemental appropriations since the 1987 biennium.

As shown, the requested amount is significantly below the 2001 biennium level, primarily due to a lower cost fire season (and expedited receipt of certain reimbursable costs) and significantly lower costs in the Department of Public Health and Human Services (DPHHS) and the Office of Public Instruction (OPI).

Figure 2 provides detail on the executive's requested supplemental appropriations.

As shown, funds are being requested for a number of agencies. In addition to the funds requested in HB 3 and HB 16, the executive

includes \$1.6 million general fund in the Executive Budget balance sheet as a contingency for unanticipated other costs.

REQUESTED SUPPLEMENTAL APPROPRIATIONS

The following briefly discusses each request. The individual supplemental requests are discussed in more detail in the individual agency narratives in the *Agency Budget Analysis* section of the *Legislative Budget Analysis*.

DPHHS - Montana Developmental Center

DPHHS requests a supplemental of \$924,354 for costs at the Montana Developmental Center (MDC). The Office of Budget and Program Planning lists two reasons for the request: 1) increased staffing to maintain Medicaid certification; and 2) costs of a lawsuit initiated by the Montana Advocacy Program (MAP). The executive notes that additional

Figure 2
Supplemental Appropriation Requests
Executive Budget - Fiscal 2003

Department/Program	General Fund
Public Health and Human Services Disability Services Division	\$ 924,354
Natural Resources and Conservation Forestry*	9,069,629
Justice Legal Services Major Litigation	250,000
Highway Patrol Prisoner Per Diem	250,000
Montana University System Indirect Cost Recoveries	76,000
Office of Public Instruction County Block Grants	377,471
School BASE Aid	<u>3,503,000</u>
Total**	\$ <u>14,450,454</u>

*Includes \$6,571,766 included in HB 16 and \$2,497,863 included in HB 3.

**The Executive Budget general fund balance sheet also includes a contingency for potential other supplementals of \$1,235,069 not included in either HB 3 or HB 16 as drafted.

revenue will be deposited to the general fund from retroactive billing of costs at MDC. However, the additional revenue from MDC retroactive billing has already been included in the revenue estimates in HJR 2 as introduced.

Requirement to Reduce Expenditures

The 1993 legislature passed legislation requiring that, in order to receive a supplemental appropriation in the first year of the biennium, agencies must detail how expenditures in the second year of operation would be reduced to contain total expenditures within the biennial appropriation. Statute makes exceptions to this requirement for the following (all of which are included in the fiscal 2003 supplemental appropriation request):

- Fire costs in the Department of Natural Resources and Conservation
- BASE aid, guaranteed tax base, or transportation aid in the Office of Public Instruction
- Prisoner per diem and litigation costs in the Department of Justice

In June, the executive presented a request to transfer \$3.9 million from fiscal 2003 to fiscal 2002 primarily for additional Medicaid costs. The executive's mitigation plan consisted of an offset of additional revenue anticipated as a result of additional billing for past allowable costs that were eligible for federal reimbursement, but for which reimbursement had not previously been sought. The Legislative Finance Committee informed the Governor that this plan did not appear to meet the statutory requirements. The executive transferred \$3.9 million general fund from fiscal 2003 to fiscal 2002, of which \$416,457 was for the Montana Developmental Center. Further, the additional revenue has already been included in the HJR 2 revenue estimates, and will not affect the supplemental cost.

A complete discussion of this supplemental request is included in the narrative for the Department of Public Health and Human Services in Volume 3 of the Legislative Budget Analysis.

DNRC - Fire Suppression

The legislature does not appropriate for the costs of fire suppression in the General Appropriations Act, and does not assume any costs when projecting the ending fund balance. Instead, all costs of fire suppression are requested of the next legislature as supplemental appropriations. Figure 3 shows that fire suppression costs have fluctuated widely in the last several biennia.

The amount requested by the executive, \$9.1 million, represents anticipated state costs for fire suppression that must be met in the 2003 biennium fire season. In prior years, this supplemental request would have been higher. Fire suppression consists of three activities: 1) direct expenditures on state-responsibility fires; 2) activities on behalf of other jurisdictions. (Montana incurs the initial cost, and is reimbursed by the responsible jurisdiction, i.e. other states or the federal government. Delayed receipt of the reimbursement usually necessitates a supplemental appropriation for the incurred cost); and 3) activities of other jurisdictions on our behalf. As in (2), the other jurisdiction incurs the initial cost, for which Montana provides reimbursement. The amount owed by Montana is also included in the supplemental request, as accounting

Figure 3
Supplemental Appropriations for Fire Costs

Biennium	Supplemental Appropriation	Statutory Appropriations	Total
1983	\$ 0.80	\$ -	\$ 0.80
1985	2.90		2.90
1987	3.74		3.74
1989	12.64		12.64
1991	3.00	0.50	3.50
1993	7.94	1.96	9.90
1995	15.50	8.92	24.42
1997	4.47	3.10	7.57
1999	10.55		10.55
2001	33.22	6.20	39.42
2003*	9.07	7.01	16.08

*Fiscal 2003 executive request

principles require that costs incurred in a given year must be paid from that year's appropriation, even if the actual payment is made in the next fiscal year.

Under conditions existing in prior years, the supplemental request would have been \$3.6 million higher. In fiscal 2003, the state incurred costs on behalf of the federal government (which acts as a clearinghouse for all inter-jurisdictional costs to simplify billing and reimbursements). Montana requested and received expedited payment of \$3.6 million in billable costs, eliminating the need to request a supplemental for that amount.

Department of Justice

There are two requests for the Department of Justice: 1) legal services major litigation; and 2) highway patrol prisoner per diem.

Legal Services Major Litigation

The 2001 legislature approved \$400,000 general fund as a biennial appropriation for major litigation on behalf of the state. The executive moved \$200,000 from fiscal 2003 to fiscal 2002 as nearly the entire biennial appropriation had been expended in fiscal 2002. The executive is requesting replacement of the transferred funds, with an additional \$50,000 for a total of \$250,000.

Major litigation funds of approximately \$129,000 were spent for the lawsuit regarding the Automated Accounting and Reporting System in the Gambling Control Division. Other major cases represented by the department during the 2003 biennium and ongoing include: mining regulation, laws regulating game farms, the school fund lawsuit, and potential tobacco lawsuits.

Highway Patrol Prisoner Per Diem

The executive requests approval for a \$250,000 general fund supplemental for prisoner per diem. This request is partially to replace funding transferred from fiscal 2003 to fiscal 2002. In June 2002, the department requested a transfer of \$112,894 from fiscal 2003 funds to fiscal 2002 for costs associated with boarding prisoners in county detention facilities. Fiscal 2003 funds were also reduced by \$32,500 in the reductions ordered by the Governor under 17-7-140, MCA.

It appears that the entire amount may not have had to be transferred in fiscal 2003. The agency also has carry-forward funds that could be used to partially mitigate the costs of this supplemental. For a further discussion, see the Department of Justice narrative in Volume 4.

Montana University System – Indirect Cost Recoveries

The executive recommends approval of \$76,000 general fund to allow the Office of the Commissioner of Higher Education (OCHE) to comply with a legislative audit recommendation to properly account for indirect costs associated with federal grants. Proper accounting procedures call for indirect cost recoveries to be deposited to the state general fund and costs to be paid from the state general fund. The OCHE had been reducing general fund expenditures in the amount of federal indirect cost recoveries because it lacked sufficient general fund authority to spend the indirect cost recoveries. The executive notes a like amount of revenue will be deposited into the general fund.

Office of Public Instruction - County Block Grants

The executive will request a supplemental for HB 124 block grants to the countywide transportation and retirement accounts for fiscal 2003. HB 124 based the block grants in fiscal 2002 and 2003 on

revenues redirected to the state. The base year for collecting this information was fiscal 2001. The block grants in fiscal 2002 and 2003 were fiscal 2001 revenues redirected times 0.76 percent growth in each year. Recently, however, county officials reviewed estimates of revenue received in fiscal 2001, and it was discovered that in many counties not all revenues given up were counted. The new data indicate that the block grants in fiscal 2003 should be increased by \$0.377 million. The executive will offer legislation to allocate this amount among the counties.

Office of Public Instruction – BASE Aid

The executive recommends a \$3.5 million general fund supplemental appropriation for BASE aid. The increase is due to lower than estimated deposits to the common school trust interest and income account established by the legislature in the August 2002 Special Session. The account was established as a result of the passage of SB 495 by the 2001 legislature that authorized the purchase of mineral rights funded by a loan from the coal trust. The revenue must be used to pay back the loan, including interest. When estimating revenues to the account, the legislature reduced the general fund appropriation to schools by the amount of anticipated deposits to the account. However, the amount of general fund reduced should have been adjusted for the amount of funds from the account that must first be used to make interest payments.

The amount requested may be too high, based upon the estimates of interest and income deposits to the account. For a further discussion, see the Office of Public Instruction narrative on page E-1 of Volume 4.

OTHER CONCERNS

As stated, the Executive Budget general fund balance sheet includes an additional \$1.2 million for contingencies. The Legislative Fiscal Division remains concerned with two areas of the budget: 1) the Department of Corrections; and 2) the Department of Public Health and Human Services.

Department of Corrections

In fiscal 2003, the Department of Corrections estimated appropriations were \$9.0 million less than anticipated costs, and instituted reduction measures. A key component of this reduction was the conditional release of 400 inmates for the remainder of the year. The department did not release as many inmates as early as anticipated, reducing its anticipated savings.

Department of Public Health and Human Services

There are two areas of concern in the Department of Public Health and Human Services:

- The department has recently taken additional reduction measures in mental health services to offset a \$1.8 million shortfall and stay within its fiscal 2003 appropriation, and indicated Medicaid primary care will be short an additional \$3.8 million in fiscal 2003
- The Child Support Enforcement Division must either reduce operations significantly or seek a supplemental appropriation of up to \$3.5 million in fiscal 2003, as its primary state account is in a deficit situation

EXECUTIVE PAY PLAN PROPOSAL

Unlike recent years, the executive does not come into the legislative session with a negotiated state employee pay plan proposal. As of the writing of this report, the executive is not in formal discussions with employee unions.

The executive has submitted legislation to increase insurance contributions per employee by \$44 per month beginning January 1, 2004 and an additional \$50 per month beginning January 1, 2005.

The legislation includes the following appropriations:

- \$8.2 million general fund and \$11.7 million other funds (\$19.9 million total) for the insurance increase
- \$1.5 million general fund and \$3.0 million other funds (\$4.5 million total) for a personal services contingency

Figure 4
Proposed Pay Plan Appropriation - Executive Budget
2005 Biennium

Entity	--- Fiscal 2004 ---			--- Fiscal 2005 ---			--- 2005 Biennium ---		
	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
Legislative Branch	\$ 24,969	\$ 7,676	\$ 32,645	\$ 81,583	\$ 24,915	\$ 106,498	\$ 106,552	\$ 32,591	\$ 139,143
Judiciary	85,726	12,247	97,973	268,867	38,410	307,277	354,593	50,657	405,250
Executive Branch	1,042,381	1,926,519	2,968,900	3,263,472	6,015,663	9,279,135	4,305,853	7,942,182	12,248,035
University System	1,087,384	1,182,729	2,270,113	2,323,048	2,526,739	4,849,787	3,410,432	3,709,468	7,119,900
Total	\$ 2,240,460	\$ 3,129,171	\$ 5,369,631	\$ 5,936,970	\$ 8,605,727	\$ 14,542,697	\$ 8,177,430	\$ 11,734,898	\$ 19,912,328
Personal Services Contingency	\$ 1,500,000	\$ 3,000,000	\$ 4,500,000				1,500,000	3,000,000	4,500,000
Total Proposed Appropriation							\$ 9,677,430	\$ 14,734,898	\$ 24,412,328

The executive is proposing to maintain current fiscal 2003 pay schedules in effect in fiscal 2003 in the 2005 biennium, including those for teachers and blue-collar workers.

INSURANCE INCREASE

The executive includes funding to maintain the same level of insurance coverage as the employee is currently receiving, thereby keeping the employee "whole". If approved the additional funding would bring the state's contribution for an employee's insurance to \$410 per month in calendar 2004 and \$460 per month in calendar 2005 from the current (as of January 1, 2003) contribution of \$366.

The executive includes a four percent vacancy savings on the total anticipated cost of the increase.

LFD ISSUE

The pay plan includes funding for all positions, regardless of funding source. As a result, positions supported with funds not appropriated by the legislature are also included. The appropriation of other funds could consequently be reduced by about \$1.6 million.

Future Costs

Because the insurance increase is phased in over the biennium, costs in the next biennium will be significantly higher - \$15.1 million general fund and \$19.3 million other funds (excluding positions for which the legislature does not appropriate funds).

PERSONAL SERVICES CONTINGENCY

The executive is proposing a contingency pool for allocation by the Office of Budget and Program Planning to agencies when personnel vacancies do not occur, retirement costs exceed agency resources, or other contingencies arise.

The legislature has appropriated funds for this purpose for several biennia.¹ In the 2003 biennium, the legislature appropriated \$1.3 million general fund and \$3.0 million other funds as a contingency. The Governor ordered that \$65,000 of the general fund appropriation not be spent under 17-7-140, MCA. During the August 2002 Special Session the legislature reduced the appropriation to \$735,000 general fund, or only enough to meet all prior obligations on the fund.

OTHER ISSUES

As stated, the executive is not proposing an increase in state employee pay in the 2005 biennium. However, agencies have other options for increasing an individual employee's pay.

- Broadband Pay – The state has embarked upon a means of classifying and paying personnel called a broadband pay plan, which is part of a larger human resource classification and pay initiative called the Montana Human Resources Competency Project. Instead of employees being in one of a number of narrowly defined “bands” for purposes of determining pay, the bands are widened to allow greater flexibility to managers to adjust duties and pay within the band. Certain agencies have made conversions to broadbanding for significant numbers of employees. While not universally true, generally the move to broadbanding has resulted in increased pay for the individuals occupying the positions. For a further discussion, see the narrative on the broadband pay plan on page 101.
- Position upgrades and reclassifications – If the duties of a position change, the position could be reclassified at a higher (or lower) pay level

Unlike a pay plan where all employees (with very limited exceptions) would receive an increase, the above options apply only to certain positions and often only certain agencies.

- Not all positions are part of the broadband pay plan
- Position upgrades, by definition, only apply to certain types of employees, and only upon specific review and reclassification
- For either adjustment, the agency would need to find the funding for any increase in its existing budget, as no additional funds are added prospectively for these purposes during budgeting
- Agencies with more discretionary funding (such as those with little general fund) have more leeway to provide increases to employees, and to have those increases funded in the next biennium²

¹ For a complete history of vacancy savings assumptions and contingency appropriations, see the Vacancy Savings narrative in this volume.

² The Department of Fish, Wildlife, and Parks and the Department of Transportation both have either all or a significant cohort of employees on a broadband pay plan, with extremely limited or no general fund.

A discussion of the broadband pay plan and associated issues is included on page 101 of this volume and in the narratives of impacted individual agencies in Volumes 3 and 4. For purposes of the pay plan discussion, the legislature should note that, while most state employees will receive no increase under the current pay plan proposal, some employees could still receive increases, and the distribution of those increases could highly favor employees of only select agencies.

FTE IMPACTS

The proposed Executive Budget will have an impact on the number of state government FTE (Full-time equivalent employees). As shown in Figure 5, total FTE would increase by 110.02 in fiscal 2004 and 56.84 in fiscal 2005 over the fiscal 2002 level. However, these increases are the net of a number of proposed increases and decreases in FTE. Generally, increases in FTE fall into two categories:

- o Almost half of the net increase in fiscal 2004 and nearly the entire net increase in fiscal 2005 is due to the inclusion of the Youth Challenge Program in the Department of Military Affairs. The 2001 legislature made this program one-time-only, meaning expenditures and FTE do not appear in the 2002 base.
- o A significant percentage of the remaining net increases are due to the provision of additional federal funds, particularly in the Office of Public Instruction and the Department of Public Health and Human Services

Figure 5 Total Proposed FTE Levels 2005 Biennium Executive Budget					
Section/Agency	Base Fiscal 2002	Net Change Fiscal 2004	Total Fiscal 2004	Net Change Fiscal 2005	Total Fiscal 2005
<u>Section A*</u>					
Legislative Branch	125.27	(1.50)	123.77	(1.50)	123.77 **
Consumer Counsel	5.04	0.00	5.04	0.00	5.04
Judiciary	357.43	16.00	373.43	16.00	373.43
Governor's Office	57.00	0.00	57.00	0.00	57.00
COPP	5.00	0.00	5.00	0.00	5.00
State Auditor	69.50	4.00	73.50	4.00	73.50
Transportation	2,170.16	(6.48)	2,163.68	(57.66)	2,112.50
Revenue	663.53	(17.50)	646.03	(21.00)	642.53
Administration	145.38	2.29	147.67	2.29	147.67
Appellate Defender	3.00	0.00	3.00	0.00	3.00
<u>Section B</u>					
PHHS	2,788.09	30.24	2,818.33	32.74	2,820.83
<u>Section C</u>					
Fish, Wildlife, Parks	581.18	17.42	598.60	18.42	599.60
Env. Quality	361.03	10.25	371.28	10.25	371.28
Livestock	139.49	6.00	145.49	6.00	145.49
DNRC	492.36	(4.10)	488.26	(4.10)	488.26
Agriculture	109.05	2.50	111.55	2.50	111.55
Commerce	68.50	(17.50)	51.00	(17.50)	51.00
<u>Section D</u>					
PSC	39.00	0.00	39.00	0.00	39.00
Crime Control	18.00	2.00	20.00	2.00	20.00
Justice	713.20	1.55	714.75	(0.45)	712.75
Corrections	1,092.80	0.00	1,092.80	0.00	1,092.80
Labor/Industry	659.64	1.50	661.14	1.50	661.14
Military Affairs	114.00	51.90	165.90	51.90	165.90
<u>Section E</u>					
OPI	114.91	10.40	125.31	10.40	125.31
Board of Public Ed	4.00	0.00	4.00	0.00	4.00
MSDB	81.68	0.00	81.68	0.00	81.68
CHE	87.06	3.00	90.06	3.00	90.06
Arts Council	7.00	0.00	7.00	0.00	7.00
Library Commish	30.50	(2.00)	28.50	(2.00)	28.50
Historical Society	57.63	0.05	57.68	0.05	57.68
Totals	11,160.43	110.02	11,270.45	56.84	11,217.27
*Secretary of State FTE are all supported with proprietary funds.					
**Does not include session staff 5.17 FTE.					

Figure 6 highlights identified FTE reductions. There are a number of issues associated with the figures shown.

- Reduced FTE represent FTE that will not be a part of the base in the 2007 biennium. If an entire function was being reduced, the FTE were generally reduced at the same time. If FTE are reduced, the positions are not maintained as part of present law for building the 2007 biennium budget, and the reductions are “permanent” until the legislature specifically restores funding. However, many agencies chose to take unspecified reductions, meaning that they would reduce personal services or operating expenditures sufficiently to live within the appropriation, without identifying particular functions. These reductions could entail involuntary employment terminations or keeping positions unfilled. However, the FTE would not be removed from the agency’s present law base and would be used to build the budget for the 2007 biennium
- Not all of the FTE reductions shown in the figure are due to budget reduction measures. For example, the largest single reduction – downsizing of Montana State Hospital and the Montana Mental Health Nursing Care Center in the Addictive and Mental Services Division in the Department of Public Health and Human Services - is in reality a shift to community services with increased overall costs. In the Department of Transportation, a large change in projected FTE is a standard feature of the budget, as FTE are estimated based upon the number and size of projected highways projects
- There may be either more or fewer involuntary layoffs than the figures shown.
 - Some positions are currently vacant
 - Some employees may have the opportunity to move into other unfilled positions, including positions added in other proposals
 - Some layoffs may occur even though the positions are not being eliminated. As stated above, if the agency has a reduced general fund appropriation, employment may be involuntarily terminated due to other budget constraints

Because of the “permanent” nature of reductions that also reduce FTE, the legislature may want to carefully consider whether reductions should include FTE. While the legislature does not appropriate FTE, and does not dictate either the level of FTE or its composition, as stated above, reduction of FTE associated with the appropriation means that the positions are not part of the budget building foundation in the 2007 biennium. Rather, reinstatement must be addressed in a new proposal.

The reductions are discussed in the narratives of the individual agencies in Volumes 3 and 4.

Figure 6
Proposed FTE Reductions
2005 Biennium Executive Budget

Agency Number	Program	FY 2004	FY 2005	Biennial Cost	
		FTE	FTE	General Fund	Other Funds
Legislative Branch					
	Audit & Examination	1.50	1.50	\$ -	\$ 53,704
Governor's Office					
	Executive Office	1.00	1.00	78,948	
	Office of Budget & Program Plan	1.00	1.00	109,799	
Office of Public Instruction					
	State Level Activities	3.00	3.00	808,966	
Justice					
	Gambling Control Division	3.00	3.00		289,387
	Motor Vehicle Division	7.45	9.45	502,399	
	Legal Services Division	1.00	1.00	72,040	
	Division of Criminal Investigations	3.00	3.00	420,240	(153,315)
State Library					
	Statewide Library Resources	2.00	2.00	106,232	
Historical Society					
	Administration	0.30	0.30	29,179	
Transportation					
	General Operations Program	2.00	2.00		155,000
	Construction Program		50.63		1,098,742
	Maintenance Program	11.03	11.03		1,037,508
Natural Resources and Conservation					
	Centralized Services	3.00	3.00	269,085	
	Conservation & Resource Development	1.00	1.00	97,540	
	Water Resources Division	1.00	1.00	156,794	
	Forestry Division	4.15	4.15	241,880	119,136
Revenue					
	Director's Office	5.00	5.00	530,600	
	Director's Office	1.00	1.00	68,575	
	Resource Management	9.50	13.00	787,816	
	Compliance Valuation and Resolution	3.00	3.00	202,367	
Administration					
	Compliance Valuation and Resolution	3.00	3.00		232,867
	Information Technology Services	1.13	1.13	89,877	
	State Personnel	1.00	1.00	50,270	50,540
Military Affairs					
	Disaster and Emergency Services Div.	1.00	1.00	72,136	
	Veterans' Affairs Division	1.00	1.00	24,828	24,828
Public Health and Human Services					
	Human and Community Services	7.50	7.50	247,145	247,145
	Human and Community Services - OPA	6.30	6.30	261,860	193,302
	Child and Family Services	1.00	1.00	40,418	44,722
	Health Policy and Services Division	2.00	2.00	63,656	115,916
	Quality Assurance Division	9.02	9.02	433,946	129,271
	Disability Services Division	5.00	5.00	530,637	66,420
	Senior and Long Term Care	1.50	1.50	81,090	34,642
	Addictive and Mental Disorders	44.49	44.49	1,553,420	
	Addictive and Mental Disorders	6.00	6.00	309,952	66,420
	Addictive and Mental Disorders	<u>3.00</u>	<u>3.00</u>		<u>206,704</u>
Totals		<u>156.87</u>	<u>213.00</u>	<u>\$ 7,931,743</u>	<u>\$ 3,739,815</u>

BROADBAND PAY PLAN

During the 2003 biennium, agencies moved a large number of state employees to a newly developed position classification and compensation system. Under the authority of 2-18-303, MCA, the State Personnel Division of the Department of Administration developed the alternative classification and compensation system known as the broadband plan. The broadband plan was developed to address several human resources management challenges, like employee recruitment and retention, that agencies state was evident by high staff turnover rates. The broadband plan places FTE into fewer position classifications with wider ranges between minimum and maximum pay levels than the other existing classification systems.

According to the State Personnel Division, the plan simplifies the classification of positions, increases the emphasis on market-based pay, and promotes competency-based human resource systems, including compensation. It also provides flexibility for adoption of other job and employee-based pay components. The plan combines grades 4 through 25 in the statewide classification plan into nine broad pay bands. Pay raises are given at the discretion of agency management and the collective bargaining process, where applicable.

In fiscal year 2002, state agencies moved 3,922.31 FTE from other classification systems to the broadband plan. Figure 7 shows the statewide movement of positions between the various plans. The figure shows the change from the pay matrix profile that existed upon completion of the 2001 legislature, to the profile that existed when the 2005 biennium personal services budgets were developed. The figure only shows information for 15 agencies that have converted positions to the broadband plan.³

Figure 7
Pay Matrix Changes
2003 Biennium to 2005 Biennium
FTE by Pay Matrix

Classification and Compensation Plan	2003 Biennium	2005 Biennium	Change
Statewide Classified Plan	8,505.13	5,209.28	(3,295.85)
Exempt Employee Plan	111.35	126.46	15.11
Information Technology and Engineering Plan	752.78	147.50	(605.28)
Broadband Plan	-	3,922.31	3,922.31
	<u>9,369.26</u>	<u>9,405.55</u>	<u>36.29</u>

FUNDING OF IMPLEMENTATION

While the concept of broadbanding alone does not increase employee costs, in almost all instances, the actual implementation of broadbanding has resulted in employee pay increases.

For most agencies, funding during the 2003 biennium to provide pay raises under the broadband plan was provided out of existing agency appropriations. Except for a few agencies that received funding specifically for broadband plan raises, the legislature did not provide funding. Therefore, while the agency had to find funding in existing appropriations initially, all increases are incorporated into the statewide present law adjustments in the 2005 biennium. As a consequence, the Office of Budget and Program Planning required agencies to submit negative new proposals to fund the broadband plan.

³ In addition to movement to the broadband plan, all classified positions in the Montana University System were moved to the Montana University System Achievement Project (MAP). MAP is a compensation and classification system for university system employees similar to the broadband plan for the executive.

If the reduction proposals to pay for the broadband pay increases are taken from operating expenses, the reductions can be permanent, as they reduce the base funding. Also, if the executive is proposing to reduce FTE to pay for the increases, this reduction is also permanent, as costs of those FTE will not be included in the 2007 biennium budget. However, if the executive is proposing to increase vacancy savings without impacting funded FTE, these reductions will be temporary.

ISSUES

The narratives for the individual agencies impacted contained in Volumes 3 and 4, include discussions of broadband pay implementation and the attendant issues. There are two main issues discussed, as appropriate:

- Whether the reduction measures proposed by the executive would result in permanent savings to fund the increases in future years, or whether the reductions are only temporary
- Whether the executive has requested decision packages to add back in functions proposed for elimination or curtailment to pay for the broadbanding increases

VACANCY SAVINGS

Vacancy savings is the difference between the cost of fully funding a position for the entire year and the actual cost of authorized employee positions during that period. A vacancy savings reduction, usually a percentage reduction from full funding, has been applied to budgets in prior years in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than appropriated. This section outlines the executive's proposal for vacancy savings.

EXECUTIVE PROPOSED VACANCY SAVINGS

The executive has applied a four percent vacancy savings rate to all personal services including insurance contributions. The rate is applied to all positions in state government with the following exceptions.

- Agencies with fewer than 20 FTE
- University system faculty
- Elected officials
- The legislative branch
- The judicial branch

The executive has applied vacancy savings to on-going positions and those proposed for inclusion by present law adjustments or new proposals. Vacancy savings reductions total \$47.2 million over the 2005 biennium, of which it is estimated that \$20.5 million is general fund. Of the \$47.2 million, \$38.7 million is from state government (excluding the university system) and \$8.5 million is from the university system.

PERSONAL SERVICES CONTINGENCY

Vacancy savings are assessed against personal services budgets on the assumption that actual vacancy savings will be sufficient to cover the reduction. Sometimes, agencies don't generate enough actual vacancy savings, which results in a budget shortfall.

In order to assist agencies that have insufficient authority to meet all personal services costs in the 2005 biennium, the executive is proposing, in the pay plan bill, a contingency fund including \$1.5 million general fund and \$3.0 million other funds. Agencies experiencing this problem would have to apply to the Office of Budget and Program Planning for these funds during the biennium.

For the 2003 biennium, the legislature provided \$1.3 million general fund and \$3.0 million other funds for a contingency fund. The Governor's spending reductions implemented in June 2002 reduced the general fund amount by \$65,000. The August special session further reduced the general fund contingency amount by \$500,000. These two actions resulted in a general fund contingency fund authority for the 2003 biennium of \$735,000, instead of the \$1.3 million.

Figure 8 shows the allocations from the contingency through December 1, 2002 (fiscal 2003). Only seven agencies received funding to date, totaling \$406,457 from the general fund contingency. Three agencies were allocated \$1,681,027 from the "other funds" contingency.

Figure 8
Allocations of the Personal Services Contingency
2003 Biennium

Agency	General Fund	Other Funds
Montana Arts Council	\$11,415	\$0
School for the Deaf & Blind	59,855	0
Historical Society	32,000	0
Department of Justice	0	60,000
Natural Resources & Conservation	12,686	0
Public Health & Human Services	185,232	1,607,827
Department of Revenue	101,969	0
Library Commission	3,300	13,200
Total	<u>\$406,457</u>	<u>\$1,681,027</u>

SERVICE REDUCTIONS

The executive is proposing known service reductions totaling \$38.6 million general fund from the fiscal 2002 base expenditures. These reductions are concentrated in human services. As stated, while general fund expenditures in other agencies are being reduced from the present law level, the executive has not specified service reductions for many of these adjustments. As a result, the actual impact to agency operations and services to citizens is not known, and may complicate the legislature's efforts to understand the impacts of and prioritize service reductions.

The figure highlights the known service reductions proposed by the executive. Service reductions are discussed in more detail in the individual agency narratives in Volumes 3 and 4.

Figure 9

Service Reductions 2005 Biennium Executive Budget		
Item	Biennial Gen. Fund	Biennial Total Funds
Public Health and Human Services		
Childcare - reduction in general fund	(953,862)	(3,532,822)
FAIM Phase IIR	-	(9,954,286)
Food Stamp Employment and Training	(176,000)	(352,000)
Childcare - TANF Transfer	-	(15,224,478)
Office of Public Assistance Reductions	(329,061)	(658,122)
Visual Service Medical	(169,668)	(169,668)
Extended Employment Benefits	(541,278)	(541,278)
Independent Living	(457,532)	(457,532)
Donated Dental	(50,000)	(50,000)
Computer maintenance and mainframe usage	(505,501)	(995,304)
Big Brothers Big Sisters	(366,528)	(366,528)
In-home Services (Foster Care)	(2,280,754)	(2,280,754)
CPS Daycare	(650,026)	(2,407,504)
Domestic Violence	(155,282)	(155,282)
DD Community Supports and Supported Living*	(2,848,790)	(5,666,190)
DD Medicaid Provider Rate Reduction*	(383,406)	(1,402,092)
Personal Services - Agencywide	(3,155,910)	(3,977,514)
Operating Plan Reductions		
HPSD		
Lower Medicaid Eligibility	(184,202)	(673,667)
Reduce Optional Services	(500,000)	(1,828,612)
Lmt Physician Services	(1,461,370)	(5,342,744)
Eliminate End State Renal	(200,000)	(200,000)
Eliminate MIAMI	(1,134,256)	(1,134,256)
Eliminate Poison Control	(77,908)	(77,908)
Public Health Lab Reduction	(370,748)	(370,748)
Reduce Family Planning	(51,896)	(51,896)
HIV/AIDS Reductions	(84,000)	(84,000)
Eliminate Farmer's Market WIC	(25,656)	(25,656)
SLTC	-	-
Lower Medicaid Eligibility	(1,381,286)	(5,045,796)
Eliminate Hospice	(367,514)	(1,355,451)
Reduce Funding to Area Aging Agencies	(514,000)	(514,000)
Reduce Home Therapy Bens.	(68,000)	(248,691)
APS Prevention Grants	(100,000)	(100,000)
AMDD	-	-
Lower Medicaid Eligibility	(31,092)	(113,699)
Reduce MHSP	(16,171,067)	(18,054,401)
Subtotal DPHHS	(35,746,593)	(83,412,879)
Other Agencies		
Justice - Motor Vehicle Division		
Titling/lien filing/drivers' licence stations/fraud investigations	(455,995)	
Justice - Division of Criminal Investigations		
Reduce services performed by fire marshals	(266,925)	
Montana Arts Council		
Art pros consultant/ arts education program/local grants	(116,446)	
Montana State Library		
Interlibrary loan reimbursements/library federation funding	(557,432)	
Natural Resources and Conservation		
Fire services to counties in western Montana	(349,893)	
Labor and Industry		
Apprenticeship Program reduction	(154,000)	
Military Affairs		
Disaster and Emergency Services/Veterans' Division FTE	(72,050)	
Revenue		
County tax appraisal services	(847,486)	
Total	(38,566,820)	(83,412,879)
Notes:		
FTE reductions, some of which are service reductions, were not included in the human services totals above - except the reduction in Public Assistance Offices		
*Division will seek refinancing to avoid service reductions		

FEE CHANGES

The executive is proposing a number of fee changes that would reduce general fund expenditures in HB 2. Changes in fees can either require legislation, or be done under the authority of governing or oversight entities or within executive authority. All but two of the changes proposed by the executive require legislation to enact.

The following table shows all requested fee increases that impact expenditures in HB 2, along with the general fund and other fund impact. The fee change with a significant general fund impact would impose surcharges of \$7 on civil and criminal court cases to replace general fund that currently supports the Law Enforcement Academy. Other significant changes included in HB 2 is a title transaction fee to fund the automation of motor vehicle registration, a proposal by the Supreme Court to maintain and increase the current surcharge on civil and criminal court cases from \$5 to \$10 for court automation, and the inclusion of fee revenue in the Child Support Enforcement Division.

Figure 10
Fee Changes Reflected in HB 2
2005 Biennium Executive Budget

Agency/Program	Biennial Impact		Legislation Required?	Comments
	General Fund	Other Funds		
Corrections				
Secure Care	\$ (100,000)	\$ 100,000	Yes	Inmates would need to buy their own utensils
Justice				
Information Technology Services	(241,633)	580,960	Yes	Increase name-based background check fee
Motor Vehicle Division		4,800,000	Yes	Title transaction fee to pay for motor vehicle registration automation
Division of Criminal Investigations	(2,210,352)	2,210,352	Yes	Surcharge on civil & criminal court cases of \$7
Supreme Court				
Supreme Court Operations	0	3,408,917	Yes	Extend automation surcharge & increase from \$5 to \$10
Agriculture				
Diagnostic Laboratory	(19,712)	19,712	No	Increase fees at Diagnostic Laboratory
Agricultural Sciences Division	(58,030)	58,030	Yes	Increase Apiary (Honey Bee) Inspection and Registration Fees
Public Health				
Child Support Enforcement*	0	1,570,800	Yes	Fee would be charged for collection of child support
Fish, Wildlife, Parks				
Field Services	0	920,000	Yes	Increase the conservation license fee to compensate school trust for hunter/angler access
Natural Resources/Conservation				
Water Resources	(46,000)	46,000	No	Require water rights applicants to pay notice fees Requires ARM change
	<u>\$ (2,675,727)</u>	<u>\$ 13,714,771</u>		

*Does not include federal matching funds

LFD COMMENT

Court Surcharges

Currently, a surcharge of \$5 is applied to all court cases, including courts of limited jurisdiction, to fund court automation. The Montana Supreme Court coordinates this effort. While the surcharge is scheduled to sunset at the end of the 2003 biennium, the Supreme Court is requesting legislation that would eliminate the sunset provision and increase the fee to \$10 per case. At the same time, the Department of Justice is proposing a surcharge of \$7 on all cases in courts of limited jurisdiction to fund the Law Enforcement Academy. Consequently, if both proposed surcharges were enacted, the total surcharge in courts of limited jurisdiction would be \$17 from the current \$5.

LFD
COMMENT
(Continued)

Both proposed surcharges are discussed in more detail the narratives for the Judiciary in Volume 3 and the Department of Justice in Volume 4.

Each of the requested changes is discussed in the individual agency narratives in Volumes 3 and 4.

REDUCED FEDERAL FUNDS

As stated, it appears to be the policy of the executive to secure as many stand-alone federal grants and programs as possible, and the executive generally attempts to meet all maintenance-of-effort requirements to ensure continued receipt of federal funds having that requirement⁴. However, the executive is proposing to reduce general fund expenditures through curtailment or elimination of some programs for which the general fund is used to match federal funds.

Figure 11 shows reduced federal funds of over \$45.0 million as a result of the executive proposals to eliminate or curtail current programs, with a general fund savings of just over \$23.0 million. As shown, the reductions are concentrated in the Department of Public Health and Human Services. Please note that the reductions are from the fiscal 2002 base.

The loss of over \$45.0 million in "imported" revenues from outside Montana could have a significant economic impact, and the legislature may want to consider this impact when setting budget priorities.

Figure 11
Reduced Federal Funds as a Result of Budget Balancing Actions
2005 Biennium Executive Budget

Agency/Function	Biennial General Fund Reduction	Biennial Federal Reduction
Public Health and Human Services		
CPS Daycare	\$ (650,026)	\$ (1,700,000)
Reduce Optional Medicaid	(500,000)	(1,328,612)
Limit Physicians Visits to 10	(1,461,370)	(3,881,374)
Reduce Provider Reimbursement	(2,668,670)	(7,087,018)
Transportation Program	(168,926)	(448,779)
Pharmacy Program Changes	(164,744)	(437,762)
Property Eligibility Exclusion - all	(1,596,580)	(5,833,162)
FTE Reduction (HPSD)	(40,418)	(44,722)
FTE Reduction (HCSD)	(24,828)	(24,828)
FTE Reduction (CFSD)	(261,860)	(187,818)
FTE Reduction (DSD)	(433,946)	(129,271)
FTE Reduction (AMDD)	(309,952)	(66,420)
FTE Reduction (SLTC)	(81,090)	(34,642)
FTE Reduction (QAD)	(63,656)	(118,916)
Hospice Elimination	(367,514)	(987,937)
Eliminate In-Home Health Therapy	(68,000)	(180,691)
Eliminate Community Supports*	(2,848,790)	(2,817,400)
DDP Medicaid Provider Rate Reduction*	(383,406)	(1,018,686)
Medicaid Provider Rate Reduction - SLTC	(1,799,771)	(4,780,783)
Medicaid Provider Rate Reduction - AMDD	(898,548)	(2,386,075)
County Offices of Public Assistance	(576,206)	(576,206)
TEAMS Computer System	(301,419)	(301,419)
CAPS Computer System	(204,082)	(188,384)
Childcare	offset against DP increase	
Food Stamps	offset against DP increase	
Subtotal DPHHS	\$ (15,873,802)	\$ (34,560,905)
Commerce		
Research and Commercialization**	(7,300,000)	(10,950,000)
Total	\$ (23,173,802)	\$ (45,510,905)
*Division hopes to create general fund savings through refinancing rather than implement this reduction.		
**Based on three-year average of federal match ratios.		

⁴ See the individual agency narratives in Volumes 3 and 4 for any LFD issues regarding the adequacy of proposed expenditures for maintenance of effort requirements for individual federal grants.

FUND SWITCHES

The executive has included a number of funding switches in her plan to balance the general fund budget. As shown, funding switches total \$23.6 million. However, portions of these reductions are due to fee changes and are also included in Figure 12. The unduplicated reduction in general fund due to fund switches totals \$21.1 million. Also, please note that almost \$900,000 of these switches will have no net effect on the general fund, as revenues are reduced by a like amount.

As shown in Figure 12, significant refinancing efforts are included in the Department of Public Health and Human Services, although the executive is also requesting replacement of federal funds in the Disabilities Services Division with general fund. In addition, the executive is recommending the replacement of about \$2.8 million lost general fund for foster care services. However, the executive did not reduce federal funds by a corresponding amount and this proposed change is not included in the figure.

The figure also includes funding switches proposed by the Governor for functions that the 2001 legislature denoted as one-time-only (OTO). Consequently, these expenditures are not included in the fiscal 2002 base and do not contribute to reduction of the projected deficit.

Each proposed funding switch is discussed in more detail in the individual agency narratives in Volumes 3 and 4.

Figure 12
Proposed Funding Switches
2005 Biennium Proposed Executive Budget

Agency/Program	General Fund Biennium	Other Funds Biennium	Comments
Supreme Court			
Supreme Court Operations	\$ (59,444)	\$ 59,444	Automation surcharge replaces general fund for computer replacements. Legislation required
Boards and Commissions**	(50,000)	50,000	Fund training for judges of courts of limited jurisdiction with registration fees
Governor's Office			
Executive Office	(100,739)	100,739	Replace Consensus Counsel general fund with state special revenue
Executive Office	(127,179)	127,179	Replace Managed Care Ombudsman general fund with federal funding authority
State Auditor			
Securities**	(758,779)	758,779	Fund program entirely with security fees/portfolio revenues.
Justice			
Central Services Division	(23,220)	23,220	Natural resource damage funds replace general fund
Division of Criminal Investigations	(153,315)	155,315	Fund grant winter position with federal funds
Division of Criminal Investigations*	(2,210,352)	2,210,352	Fund Law Enforcement Academy with a surcharge on civil & criminal cases. Pending legislation
Information Technology Services Div.*	(241,633)	580,960	Background check fee to replace general fund
University System			
Appropriation Distribution	(860,175)	860,175	Increased six-mill levy revenue offsets like amount of state general fund
School for the Deaf and Blind			
Education	(113,990)	113,990	Continue special session fund switch replacing general fund with MTAP funds
Historical Society			
Administration Program	(35,000)	35,000	Replace general fund with increased administrative charge to commissions
Environmental Quality			
Enforcement Division	(130,000)	130,000	Legislation is required to divert air quality fees from general fund to state special fund for switch
Permitting and Compliance Division	(80,000)	80,000	Re-assign positions to utilize junk vehicle fee in a funding switch
Permitting and Compliance Division	(73,000)	73,000	Funding switch would utilize water permit fees
Natural Resources and Conservation			
Forestry*	(46,000)	46,000	Require water rights applicants to pay notice fees. Funding switch would utilize state special revenue
Forestry	(173,150)	173,150	Federal funds would be used to replace general fund to pay personal services costs
Administration			
Administration and Finance	(33,441)	33,441	Move 0.33 FTE to proprietary funding
Administration and Finance	(913,878)	913,878	Move centralized services, including 6.00 FTE, to an indirect cost pool
General Services	(853,727)	853,727	Fund common area maintenance with capital land grant funds
Public Health and Human Services			
Child and Family Services	(3,000,000)	3,000,000	Refinance existing general fund costs with federal funds, Title IV-E and Medicaid
Health Policy and Services Division	(8,137,892)	8,137,892	Offsets CHIP general fund match (\$4.2 million) and Medicaid match (\$3.9 million) - 1-146
Disability Services Division	(1,800,000)	1,800,000	Services previously funded with general fund to be paid by Medicaid
Disability Services Division	1,899,878	(1,899,878)	General fund increase to maintain services previously funded with federal funds
Addictive and Mental Disorders Division	(2,190,316)	2,190,316	Increase amount of nursing home intergovernmental transfer to fund mental health Medicaid benefits
Addictive and Mental Disorders Division	(2,000,000)	2,000,000	Divert alcohol tax funds previously distributed to local chemical dependency programs for mental health Medicaid match
Addictive and Mental Disorders Division	(1,306,200)	1,306,200	Use county funds that support community mental health centers as mental health Medicaid match
Total	\$ (23,571,552)	\$ 23,912,879	
Total Unduplicated in "Fee Changes" Figure	\$ (21,073,567)	\$ 21,075,567	

Funding Switches for Programs OTO by Previous Legislature (Not in Fiscal 2002 Base)

Agriculture			
Agricultural Development Division	\$ (118,887)	\$ 118,887	Organic Certification Program
Military Affairs			
Youth Challenge Program	(2,250,880)	2,250,880	Youth Challenge Program

*Also included in the "Fee Changes" figure and discussion

**No impact on general fund, as revenues are reduced a like amount.

GOVERNOR'S ECONOMIC DEVELOPMENT PROGRAM

In the 2005 biennium, the Governor carries over all economic development programs funded in HB 2, but makes several changes to economic development programs receiving statutorily appropriated funding. Figure 13 below is a funding comparison for programs funded in the 2003 biennium and those proposed for the 2005 biennium. It should be noted that 2003 biennium funding includes the Governor's mandated expenditure reductions and reductions made during the August 2002 Special Session, which reduced general fund to these programs by over \$2.6 million. Additionally, the 2005 biennium figures include proposals contained in the Executive Budget that are contingent on passage and approval of specific legislation.

Figure 13
Economic Development Funding Comparison
2003 Biennium to 2005 Biennium

Agency/Program	Authority	2003 Biennium		2005 Biennium	
		General Fund	Other Funds	General Fund	Other Funds
Commerce					
Business Resources Division	HB 2	\$2,326,698	\$8,139,846	\$3,285,954	\$6,770,000
Small Business Development Center	Statutory	250,000	-	250,000	-
Small Business Innovative Research	Statutory	100,000	-	100,000	-
Certified Communities	Statutory	425,000	-	850,000	-
Montana Manufacturing Extension Center (1)	Statutory	400,000	-	400,000	-
Export Trade Enhancement	Statutory	600,000	-	600,000	-
Research and Commercialization	Statutory	8,015,000	-	-	-
Governor's Office					
Office of Economic Development	HB 2	1,630,151	-	1,621,000	-
Workforce Development (2)	HB 2	-	-	-	231,586
State-Tribal Economic Development Com. (3)	HB 2	-	2,000,000	-	2,000,000
Business Recruitment and Retention	Statutory	390,637	-	-	-
Agriculture					
Growth Through Agriculture (4)	HB 2	-	579,949	-	387,666
Growth Through Agriculture	Statutory	2,175,000	-	1,250,000	-
Total		\$16,312,486	\$10,719,795	\$8,356,954	\$9,389,252

(1) Funding provided to Department of Commerce, but administered by MSU.

(2) Funding provided to Governor's Office through transfer of Workforce Development Act funding from DLI.

(3) Biennial appropriation for authority to spend federal funds that might be received for state-tribal economic development.

(4) Funded from coal severance tax shared state special revenue fund.

In the 2005 biennium, the executive proposes to reduce general fund spent on economic development by almost 50 percent from the 2003 biennium funding levels. The major changes effecting this reduction include:

- Elimination of the statutory appropriation for Research and Commercialization Grants. This reduction is part of an overall executive proposal to eliminate the Board of Research and Commercialization and all funding for grants. This proposal would reduce general fund expenditures by over \$8.0 million over the biennium, and is contingent upon passage and approval of legislation
- Elimination of the statutory appropriation for Business Recruitment and Retention. For the 2003 biennium, the Governor's Office of Economic Development was to receive an annual appropriation of \$350,000 for business recruitment and retention. During the August 2002 Special Session, the appropriation was reduced to \$175,000 for fiscal 2003 through fiscal 2005, when the appropriation was to sunset. This reduction, combined with prior reductions under 17-7-140, MCA, of \$134,363, resulted in \$40,637 available

for expenditure in fiscal 2003. For the 2005 biennium, the executive proposes to eliminate the statutory appropriation and 1.00 FTE within the Office of Economic Development. Elimination of the statutory appropriation is contingent upon passage and approval of legislation

- Reduction of the statutory appropriation for the Growth Through Agriculture Program. During the August 2002 Special Session, the \$1,250,000 million annual statutory appropriation to the Growth Through Agriculture Program was reduced to \$925,000 for fiscal 2003 only. For the 2005 biennium, the executive proposes to reduce the appropriation by 50 percent from the current level, to \$625,000 per year. This proposal is contingent upon passage and approval of legislation.

Additionally, the executive proposes a reduction in Growth Through Agriculture Program funding from the coal severance tax shared state special revenue fund. For the 2005 biennium, the executive proposes to reduce the portion of coal severance tax collections allocated to the shared account. This will, in turn, necessitate a reduction in the appropriations from that account. The net result is an approximate 50 percent reduction to the state special revenue appropriation to the Growth Through Agriculture Program.

Under current law, all of the statutory appropriations in Figure 13 will sunset at the end of fiscal 2005. While the Governor has proposed legislation to extend some of those appropriations, the proposal was not received in time for inclusion in this analysis. Further analysis to determine the overall affect on these programs will be conducted for the legislative session.

For more information on the programs in Figure 13, see the corresponding agency narratives in Volumes 3 and 4 of this analysis.

FIXED COSTS

Several programs within state government provide services to other functions of state government, for which they charge a fee. The legislature budgets funds so that the agencies receiving services can meet the costs of those services. The legislature does not appropriate funds for the provider programs because they are utilizing internal service funds, which do not require appropriations. In those cases, the legislature approves the rates charged by provider programs.

Figure 14 details each of the internal service programs and the total fixed costs included in the Executive Budget in support of funding those functions. The figure also compares total costs in the Executive Budget in the 2005 biennium with costs budgeted in the 2003 biennium.

Figure 14
Comparison of Fixed Costs
2003 to 2005 Biennium
(in Millions)

Subcommittee/Agency	Program	2003 Biennium	2005 Biennium	Difference	Percent
General Government					
Administration	Insurance and Bonds	\$ 16.714	\$ 30.223	\$ 13.509	80.8%
	Warrant Writing Fees	1.677	1.733	0.056	3.4%
	Payroll Service Fees	0.727	0.897	0.170	23.4%
	Data Network Services	18.836	19.455	0.619	3.3%
	SABHRS Operating	8.351	9.446	1.095	13.1%
	Messenger Services	0.34	0.268	(0.072)	-21.2%
	Rent - Buildings	8.941	11.506	2.565	28.7%
Legislative Audit Division	Audit Fees	2.973	2.799	(0.174)	-5.9%
Natural Resources and Commerce					
Fish, Wildlife, and Parks	Grounds Maintenance	0.64	0.653	0.013	2.0%
Various	State Fund Allocation Plan/MTTPRIME Bonds	<u>5.811</u>	<u>2.209</u>	<u>(3.602)</u>	-62.0%
Total		<u>\$ 65.010</u>	<u>\$ 79.188</u>	<u>\$ 14.178</u>	21.8%

As shown, fixed costs increase by over \$14.2 million in the 2005 biennium over the 2003 biennium appropriations. Unlike previous biennia, costs for most charges do not show significant increases, with the allocation reduced in three functional areas. While rent shows a significant increase, over 95 percent of the overall increase in fixed costs is attributable to one area – insurance, which increases over 80 percent. The increase has been attributed to the following:

- Repayment of a general fund loan
- Increased number of exposure units
- Increased value of assets
- Unfavorable insurance market conditions due to the downturn in the equity market and the insurance payouts associated with the events of September 11, 2001
- Inflation in medical costs, attorney fees, and court awards

For a further discussion of the insurance cost increase, see the narrative for the Department of Administration in Volume 3 page A-245.

Each of the fixed costs and related issues enumerated above are discussed in greater detail in the respective agency budget narratives included in Volumes 3 and 4 of the *Legislative Budget Analysis*.

INFLATION/DEFLATION

The Executive Budget does not include a general inflation factor for all operating expenses, but instead applies an inflation or deflation factor to fiscal 2002 expenditures for 18 specific items.

Figure 15 shows Executive Budget inflation and deflation factors and the items to which they are applied. Of the 18 items, 8 are purchased outside of state government. The other items or services are purchased from other state agencies, and payments for these items or services go into a proprietary account. The legislature sets the rates that other state agencies must pay for the items or services, and thus determines the fund levels maintained in proprietary accounts.

Figure 15
Inflation and Deflation Factors

Account	Item Name	Percent Change		Dollar Change					
		From Fiscal 2002		State Agencies		University System		Total	
		Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005	Fiscal 2004	Fiscal 2005
<u>Inflation</u>									
62142	Disk Storage Charges DofA	10.00%	10.00%	\$83,211	\$83,211	\$51	\$51	\$83,263	\$83,263
62168	Read/Write Computer Trans DofA	10.00%	10.00%	35,801	35,801	9	9	\$35,810	\$35,810
62172	Batch CPU Seconds DofA	10.00%	10.00%	140,452	140,452	166	166	\$140,618	\$140,618
62175	System Development DofA	20.00%	20.00%	4,923	4,923	0	0	\$4,923	\$4,923
62177	TSO CPU Seconds DofA	10.00%	10.00%	28,191	28,191	15	15	\$28,206	\$28,206
62178	IDMS CPU Seconds DofA	10.00%	10.00%	197,717	197,717	6	6	\$197,722	\$197,722
62180	CICS CPU Seconds DofA	10.00%	10.00%	15,361	15,361	6	6	\$15,366	\$15,366
62185	Laser Print DofA	30.00%	30.00%	98,255	98,255	56	56	\$98,311	\$98,311
62216 *	Gasoline	11.00%	16.00%	139,277	202,585	9,051	13,166	\$148,328	\$215,750
62242 *	Diesel Fuel	11.00%	16.00%	2,872	4,177	2,926	4,256	\$5,798	\$8,433
62304	Postage & Mailing	8.00%	8.00%	420,065	420,065	86,723	86,723	\$506,789	\$506,789
62370	Telephone Equipment Charges DofA	33.00%	33.00%	586,826	586,826	155,970	155,970	\$742,796	\$742,796
62404 *, **	In-State State Motor Pool	1.00%	9.00%	17,181	154,632	384	3,453	\$17,565	\$158,085
62601	Electricity	10.00%	11.00%	403,994	444,394	342,505	376,755	\$746,499	\$821,149
Subtotal				\$2,174,124	\$2,416,587	\$597,868	\$640,632	\$2,771,992	\$3,057,219
<u>Deflation</u>									
62141	Tape Megabytes	-100.00%	-100.00%	(\$21,980)	(\$21,980)	(\$8)	(\$8)	(\$21,988)	(\$21,988)
62141	Tape Storage Charges DofA	-100.00%	-100.00%	0	0	\$0	\$0	\$0	\$0
62385	Long Distance Charges DofA	-22.00%	-22.00%	(\$27,178)	(\$27,178)	(\$101,487)	(\$101,487)	(\$628,665)	(\$628,665)
62603 *	Natural Gas	-5.00%	-4.00%	(\$104,405)	(\$83,524)	(\$126,638)	(\$101,311)	(\$231,043)	(\$184,834)
Subtotal				(\$653,563)	(\$632,682)	(\$228,133)	(\$202,805)	(\$881,695)	(\$835,487)
Net Change				\$1,520,562	\$1,783,906	\$369,735	\$437,827	\$1,890,297	\$2,221,732

* Actual percentages used for inflation in the Executive Budget are greater than those noted in the "Governor's Executive Budget".

** Actual amounts used for inflation/deflation in the Executive Budget are less than those noted in the "Governor's Executive Budget".

LFD COMMENT

The items in the table with asterisks denote inflation/deflation factors that are different than those shown in the "Governor's Executive Budget" publication.

LONG-RANGE PLANNING PROPOSALS

The Governor's request for Long-Range Planning includes a total of \$75.5 million for grants, loans, capital projects, and environmental cleanup. The request is summarized in Figure 16.

The most significant funding request for Long-Range Planning includes a total of \$46.1 million for projects included under the Long-Range Building Program (LRBP). This request, if approved, would represent the smallest LRBP request since the 1995 biennium. For the first time since the 1989 biennium, the LRBP contains no recommendations for bonded projects. Consequently, no new general fund debt service payments will be incurred during the 2005 biennium through this program.

The Governor's Long-Range Planning package includes a request for bonds to match funding through the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) to pay for the environmental cleanup efforts in the Libby and Troy areas. In 2002, the Governor shot the "silver bullet" and had the cleanup of Libby and Troy moved to a priority position on the federal government's superfund list. Past legislatures provided the authorization for \$10.0 million for CERCLA match (75-10-623, MCA), and the executive is requesting \$9.0 million for the project. The debt service for a \$9.0 million bond issue, assuming a 20-year period, is estimated to cost \$712,753 annually.

If the Governor's Long-Range Planning package is approved, two ongoing programs will experience significant funding reductions. Both the Cultural and Aesthetic Grant Program (C&A) and the Treasure State Endowment Program (TSEP) will face reduced grant funding in the 2005 biennium.

C&A will see reduced interest earnings in the future because of a temporary diversion of the flow of the coal severance tax away from the corpus of the Cultural Trust and into the general fund through the 2005 biennium. This change will reduce the interest flowing into the C&A grant program by approximately \$27,000 during the 2005 biennium, which equates to a reduction in the grant program of approximately 11.0 percent.

TSEP will have fewer funds for grants during the 2005 biennium and into the future. This is the result of a diversion of \$8.4 million of the expected TSEP interest earnings to replace general fund support of K-12 school facility payments. In the future, the proposal includes an increased coal severance tax allocation to the TSEP trust from 25.0 percent (50.0 percent of 50.0 percent) to 37.5 percent (75.0 percent of 50.0 percent) to generate higher interest earnings in the future. Despite the increased coal severance tax distribution, the trust fund will never be able to generate sufficient future interest earnings to fund projects at the current law level.

Section F, in Volume 4, includes detailed information regarding each of the programs related to Long-Range Planning.

Figure 16
Executive Budget Request
Long-Range Planning
2005 Biennium

Program/Project	Amount	Program Total
Long-Range Building Program		\$46,134,312
Projects Funded with Cash/Current Revenues	46,134,312	
Projects Funded with Bonded Debt	-	
Treasure State Endowment Program		6,973,695
Grants	6,973,695	
Loans	-	
State Building Energy Conservation Program		2,500,000
Resource Indemnity Trust Grant & Loan Programs		19,169,290
Renewable Resource Grants	4,000,000	
Renewable Resource Loans	12,169,290	
Reclamation & Development Grants	3,000,000	
Cultural & Aesthetic Grant Program		762,827
Grants	732,827	
Capital Artwork Care and Conservation	30,000	
Libby Bond Program		9,000,000
Total		<u>\$75,540,124</u>



EXECUTIVE BUDGET – OTHER LFD ISSUES

INTRODUCTION

This section contains LFD issues related to the Executive Budget as a whole. These issues are in addition to specific issues raised in the agency budget presentations. Each item is listed here and discussed in further detail in the following pages.

HIGHLIGHTS

Structural Balance. Structural balance refers to the matching of ongoing expenditures of government with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. The legislature is facing a structural imbalance in the proposed Executive Budget.

Present Law and New Proposals. The distinction between what constitutes a present law adjustment and what constitutes a new proposal is an important one. Statute requires delineation as to whether existing services or new initiatives are being funded. The LFD identified instances in which the decision packages reported as present law adjustments should have been considered new proposals.

Budget Detail. The Executive Budget, in many instances, lacks sufficient detail to allow LFD staff to perform an effective budget analysis.

Policy Issues – Lack of Specificity. Unspecified reductions in the Executive Budget are a large part of the executive solution to the deficit. As a result, the legislature does not have the information on actual impacts of the spending level proposed by the executive necessary for making policy and prioritizing services.

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of ongoing expenditures with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. If expenditures exceed revenues, then structural *imbalance* occurs. General fund expenditures exceeded ongoing revenues for 12 of the past 20 years (see Figure 1). In the mid- to late-1990's, the legislature made significant progress, reaching a sizable positive balance in fiscal 2000. It should be noted that during this time, Montana as well as other states were reaping the benefits of an information technology boom and the significant increase in capital gains taxes. However, the pendulum shifted the other way beginning in fiscal 2001, where revenues were slightly above expenditures. The unprecedented revenue shortfall in this biennium intensifies the potential for an imbalance in the upcoming biennium. Historically, legislators

have faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in corrections costs, increased human services demands, rising enrollments and funding requirements in education, and a larger debt service obligation. In the 2003 session, legislators will face the difficult task of reducing or eliminating programs and services and/or

adopting revenue enhancements. Achieving structural balance is a significant fiscal issue that not only affects the Fifty-eighth Legislature but will also establish policy decisions for subsequent legislatures.

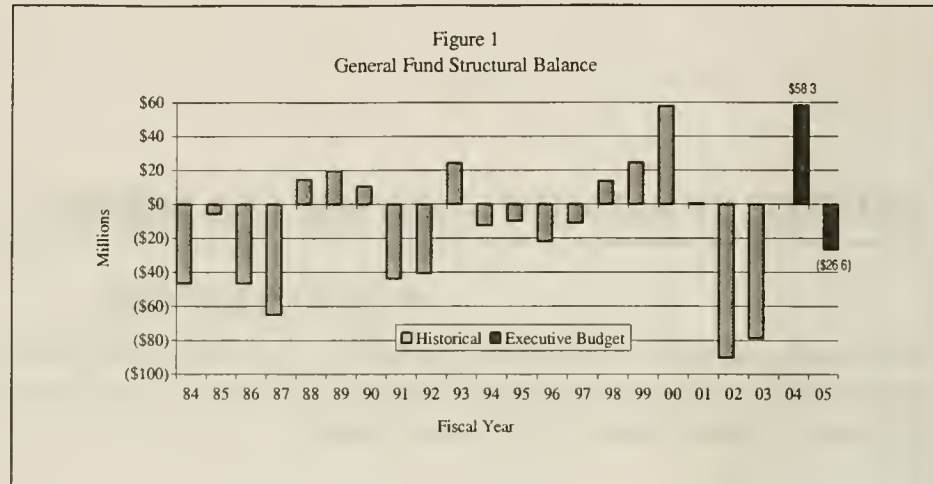


Figure 2
Revenue and Disbursement History
General Fund & School Equalization Accounts
In Millions

Fiscal Year	General Fund Revenue	General Fund Disburse.	Surplus / Deficit	School Equalization Revenue	School Equalization Disburse.	Surplus / Deficit	GF/SEA Revenue	GF/SEA Disburse.	Surplus / Deficit	Biennium Surplus/Deficit
A 84	\$330.305	\$357.387	(\$27.082)	\$242.384	\$261.753	(\$19.369)	\$572.689	\$619.140	(\$46.451)	
A 85	364.522	380.359	(15.837)	281.275	271.016	10.259	645.797	651.375	(5.578)	(\$52.029)
A 86	349.541	366.815	(17.274)	252.899	282.166	(29.267)	602.440	648.981	(46.541)	
A 87	346.690	391.325	(44.635)	263.052	283.428	(20.376)	609.742	674.753	(65.011)	(111.552)
A 88	391.152	370.853	20.299	276.216 *	281.886	(5.670)	667.368	652.739	14.629	
A 89	411.729	388.270	23.459	275.589 *	279.536	(3.947)	687.318	667.806	19.512	34.141
A 90	447.962	432.323	15.639	282.389	287.393	(5.004)	730.351	719.716	10.635	
A 91	420.257	457.612	(37.355)	385.031	391.500	(6.469)	805.288	849.112	(43.824)	(33.189)
A 92	487.036	523.072	(36.036)	393.591 *	398.059	(4.468)	880.627	921.131	(40.504)	
A 93	539.955	523.553	16.402	412.903	405.067	7.836	952.858	928.620	24.238	(16.265)
A 94	480.021	497.921	(17.900)	411.834	406.388	5.446	891.855	904.309	(12.454)	
A 95	646.149	535.461	110.688	289.199 *	409.822	(120.623)	935.348	945.283	(9.935)	(22.389)
A 96	963.193	984.997	(21.804)				963.193	984.997	(21.804)	
A 97	986.570	997.835	(11.265)				986.570	997.835	(11.265)	(33.069)
A 98	1,034.382	1,020.591	13.791				1,034.382	1,020.591	13.791	
A 99	1,068.111	1,043.418	24.693				1,068.111	1,043.418	24.693	38.484
A 00	1,163.641	1,105.598	58.043				1,163.641	1,105.598	58.043	
A 01	1,269.472	1,268.938	0.534				1,269.472	1,268.938	0.534	58.577
A 02	1,265.713	1,355.903	(90.190)				1,265.713	1,355.903	(90.190)	
F 03	1,208.408	1,287.279	(78.871)				1,208.408	1,287.279	(78.871)	(110.484)
F 04	1,350.845	1,292.539	58.306		Executive Budget		1,350.845	1,292.539	58.306	
F 05	1,291.225	1,317.838	(26.613)		Executive Budget		1,291.225	1,317.838	(26.613)	31.693

* Excludes education trust & general fund transfers.

Note: The 1995 Legislature de-earmarked school equalization revenue to the general fund.

Figure 2 shows that the anticipated revenues, using revenue estimates adopted in HJR 2, would exceed expenditures proposed in the Executive Budget during the 2005 biennium by \$31.7 million. However, included in the anticipated revenue is the impact of all executive revenue proposals, including the \$93 million transfer from the coal severance tax permanent trust fund as well as three other one-time revenue sources totaling over \$18 million. Inclusion of one-time sources of revenue results in a

misleading estimation of structural balance. Since the Executive Budget uses a large amount of one-time revenues to resolve the deficit, it is important to adjust for them to determine ongoing revenues. Further, since there is a significant difference in the revenue estimates for fiscal 2004 versus fiscal 2005 due to assumptions that the revenue collections will show increased recovery in fiscal 2005, it would be appropriate to use fiscal 2005 alone to estimate the level of structural balance. The following narrative establishes the adjustments necessary for one-time revenues and expenditures to arrive at a comparison of ongoing revenues to ongoing expenditures.

One-time revenues

The Executive Budget includes \$111.3 million in one-time revenues for the biennium, as shown in Figure 3. However, most are received in fiscal 2004, and only \$7.8 million are applied in fiscal 2005.

Figure 2 shows a \$26.6 million structural imbalance even before removing one-time revenues. Excluding the \$7.8 million in one-time revenues from the structural balance equation would result in a fiscal 2005 structural imbalance of \$34.4 million.

One-time expenditures

The Executive Budget as submitted does not designate any significant expenditures as one-time. Therefore, there is no need to adjust the projected structural balance estimate for one-time expenditures. It is possible, however, that the legislature may budget for some services on a one-time only basis. If this occurs, such expenditures can be used to offset the negative implications of one-time revenue.

Figure 3 Executive Budget Proposal One-Time Revenue (Millions)			
Item	Fiscal 2004	Fiscal 2005	2005 Biennium
State Fund Transfer	\$4.3	\$3.8	\$8.1
Extend Coal, Oil & Gas, Metal Reallocation	4.2	4.0	8.2
Terminate Infrastructure Credit	2.0	0.0	2.0
Permanent Coal Tax Trust Transfer	<u>93.0</u>	<u>0.0</u>	<u>93.0</u>

LFD ISSUE

Based on their submitted balance sheet, the Executive Budget proposal for fiscal 2005 shows revenues are nearly \$7 million less than disbursements. Further, the executive uses at least \$7.8 million in one-time revenues in fiscal 2005. Additionally, since the revenue estimates adopted by the Revenue and Transportation Interim Committee in HJR2 and other adjustments are lower than the executive estimates, the imbalance becomes even greater when using legislative numbers. Figure 4 shows the structural imbalance for fiscal 2005, comparing executive and legislative numbers. The structural imbalance in fiscal 2005 is \$16 million using executive numbers, and \$34 million using legislative numbers. As mentioned above, this is a fiscal recommendation that will have an impact on subsequent legislatures.

Figure 4 Structural Imbalance Fiscal 2005 (Millions)		
Item	Executive	Legislative
Anticipated Revenue	\$1,306.3	\$1,291.2
One-Time Revenue	<u>(\$7.8)</u>	<u>(\$7.8)</u>
Ongoing Revenue	1,298.5	1,283.4
Ongoing Expenditures	<u>1,314.8</u>	<u>1,317.8</u>

Expenditure proposals

There are three other ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- o Expanded expenditure growth such as that adopted by the 2001 legislature at 8.6 percent (subsequent actions reduced that increase). The 2005 biennium Executive Budget is proposing

extensive reductions, which should impact the structural balance positively, if those reductions are permanent.

- Realization of delayed implementation of expenditures. Annualization of the 2005 biennium pay plan will require an additional \$6.9 million general fund, and the averaging of school funding ANB in 2005 will cost an additional \$14.0 million general fund in the 2007 biennium.
- Growth in services rising from expansions in such programs as Medicaid or from increases in populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be ongoing revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth.

Achieving structural balance is a significant policy issue that the Fifty-eighth Legislature will need to address. If successful, in the 2005 biennium the legislature will make the budget process less problematic for both the executive and legislative branches in subsequent biennia.

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the Executive Budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance, and safety related costs. This fund is in a state of structural imbalance. In other parts of the Executive Budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed ongoing revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated ongoing revenues.

PRESENT LAW AND NEW PROPOSALS

Present law is defined in statute as “that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- Changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- Changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- Inflationary or deflationary adjustments; and
- Elimination of nonrecurring appropriations.”

New proposals are defined as “requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.”

Statute also states that the distinction between new proposals and adjustments to the base will be based on constitutional and statutory requirements. If either is absent, the change should be requested in a new proposal.

The concept of present law versus new proposals allows the legislature to examine requested adjustments to the budgets by determination of what constitutes a change necessary or desired

because of decisions already made and currently in place, versus changes desired to implement new programs or a change in direction, or because of changing financial circumstances. As such, the legislature can determine whether underlying and current decisions, policies, or statutes must be changed in order to avoid or reduce the requested adjustment, or whether the decision is significantly more discretionary. Subsequently, new proposals are generally given more scrutiny than present law adjustments because of the increased discretion they embody. There are two primary rationales for why it is imperative that requested adjustments be appropriately categorized between new proposals and present law adjustments.

- If new programs or other policy decisions are inappropriately categorized as present law, they may not be examined with the same scrutiny as new proposals because of this inherent assumption. In addition, it is imperative to maintain the integrity of the present law adjustment concept as one that truly reflects what is needed to maintain operations.
- New proposals are used to determine the rate or level of expansion or retraction of state government, both as requested by the executive and as implemented by the legislature. Therefore, inappropriate categorization clouds the determination of the “real” costs of providing services as currently required by law and the cost of something new or service reductions. Consequently, the distinction begins to lose meaning.

The distinction between a present law adjustment and a new proposal will often be nebulous for certain types of adjustments. However, there should be little doubt in most instances, and no doubt when statutes specifically direct the type of adjustment.

Events in the 2003 biennium made the determination of present law more challenging than normal. The large budget deficit, the first time implementation of executive spending reductions under 17-7-140, MCA, and a special session clouded the characterization of present law. The executive has generally maintained an appropriate distinction between general fund present law adjustments and new proposals. However, there were two categories of adjustments made by the executive that are brought to the legislature’s attention:

- The executive treated the Governor’s spending reductions for fiscal 2003 as present law reductions. Statute clearly states that present law is “that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature.”(emphasis added) The reductions were made by the Governor and did not have legislative action. In an opinion issued by the legislative legal counsel, executive reductions under 17-7-140, MCA are not present law reductions, and should be treated as reductions of existing services, which would be new proposals. While in most cases a decision package for the reduction exists, it may create confusion as to whether it is implementation of previous legislative decisions or a reduction in existing legislatively authorized services.
- The executive treated the majority of the fiscal 2003 legislative appropriation reductions (August 2002 special session) as a present law reduction. Statute is not clear as to whether this should be a present law or new proposal adjustment. It is only important that the legislature recognize how they were classified in the Executive Budget. The reductions were generally characterized as if the legislature had made these reductions permanent, although it is not clear that is what the legislature intended. It is also important to note that the reductions imposed in the Executive Budget to achieve the level of reductions taken in special session were simply taking the appropriation authority away. The services or functions being reduced are in most cases non-specific, and do not necessarily represent the same service reductions taken in special session.

BUDGET DETAIL

Statute addresses the need of the legislature and its staff for early submission of budget detail of the entire Executive Budget, and establishes a November 15 deadline for this submission. This provides the legislature an opportunity for analysis and review of the budget proposal in preparation for the session.

Some portions of the published Martz Budget are presented in only outline form, with little explanation of the policies needed to implement the proposed change or the mechanics of implementing the initiatives. In some instances, initiatives are not discussed at all in the November 15 budget document. The LFD has raised this same concern in the last four budget analyses, and this continues to be an area that should be of concern to legislators. The lack of budget detail makes it difficult for legislators and the public to review the budget and for staff to analyze many proposals thoroughly. In some cases staff could only raise questions, since budget details were insufficient to reach conclusions and provide options. Therefore, the opportunity for the legislature to obtain a clear understanding or analysis of these issues in advance of the session is impaired.

POLICY ISSUES - LACK OF SPECIFICITY

The executive proposes a number of reductions to agency budgets to achieve a proposed HB 2 appropriation level. In many instances, the executive establishes a target general fund level in individual agencies but does not specify what service or operational reductions would be necessary or desirable to meet the targets. Unspecified reductions in the Executive Budget are a large part of the executive solution to the deficit. As a result, the legislature does not have the information on actual impacts of the spending level proposed by the executive necessary for making policy and prioritizing services for these proposed reductions.

The largest single component for which this applies is the Montana University System (MUS). As shown on page 70, the executive is proposing over \$25 million in reductions to the MUS⁵. While the Board of Regents is responsible for managing the system and will make all decisions on how the system will live within the appropriation, the executive has not provided the Board of Regents with any guidelines or suggestions on priorities or inherent policy within the proposed reduction, including the level of any potential offsets with increased tuition.

LFD staff has attempted to ascertain potential impacts on services within agencies, as discussed in the narratives for individual agencies in Volumes 3 and 4. However, the legislature may want to require specific statements of impact of the proposed reductions in each agency and articulate its own expectations and priorities to ensure they are maintained in the 2005 biennium.

⁵ If offsets taken against statewide present adjustments are added, the unspecified reduction from present law is over \$40 million.

OTHER FISCAL ISSUES TO CONSIDER

LFD Perspective





OTHER FISCAL ISSUES

INTRODUCTION

This section discusses several fiscal issues not directly related to the Executive Budget, but that will potentially have an impact on the budget passed by the legislature and/or the budget process. The purpose of this section is to provide legislators with an overview of each of these issues. The issues discussed in this section are listed below and are discussed in more detail in the pages that follow.

- **Tobacco Settlement Funds.** The state expects to receive \$57.2 million in the 2005 biennium, at least 40 percent of which will be deposited into a trust. Another 49 percent was earmarked for specific purposes by ballot initiative in the 2002 election.
- **District Court Assumption.** The executive recommends a 2005 biennium budget for district court assumption of \$37.3 million. This is approximately \$17.2 million less than the amount requested by the Judicial Branch, and \$18.9 million more than 2003 biennium funding.
- **General Fund Statutory Appropriations.** Expenditures from statutory appropriations in the 2005 biennium are estimated at \$268.1 million, of which \$167.2 million is for entitlement payments to local government.
- **General Fund Non-Budgeted Transfers.** These transfers from the general fund to other funds in the 2005 biennium, at \$31.8 million, are markedly higher than in biennia that preceded HB 124 (2001 regular session).
- **General Fund Cash Position.** The project general fund ending cash position for fiscal 2003 is at a historical low point. The importance of the cash position is significant and sufficient cash is required to pay the state's budgeted obligations and close out the fiscal year books.
- **Local Government Assistance Restructuring.** Entitlements for counties, cities and consolidated governments will be \$7.5 million higher in the 2005 biennium than in the 2003 biennium. These rates of growth exceed the expected rate of growth in state revenues for the 2005 biennium.
- **Mental Health Services: Interim Study.** The Legislative Finance Committee has proposed five bills to implement recommendations of its mental health services study subcommittee.
- **Fund Balance Adequacy/Reserves.** With the experiences of the current biennium still fresh, the legislature will need to determine what amount of ending fund balance is sufficient to ensure budget stability, particularly with the uncertainties of Montana's revenue stream and its overall economic outlook.
- **Accruals.** Some expenditure accruals in fiscal 2002 not liquidated in fiscal 2003 can be removed according to the Legislative Fiscal Division.

- **Unified Computer Budget.** 17-7-123(1)(e)(iii), MCA requires that the Executive Budget include a “summary of budget requests that include proposed expenditures on information technology resources.” With this presentation, the legislature should be able to understand the magnitude and diversity of the information technology costs in the state budget, but is the information provided adequate for policy makers?
- **Other Major Funds.**
 - *Highway Special Revenue Account.* The 2003 legislature is faced with a declining working capital balance in the highways state special revenue account.
 - *Resource Indemnity Account.* Of seven accounts that have historically received portions of RIT allocations or interest earnings, four are projected to have negative balances by the end of the 2005 biennium.

TOBACCO SETTLEMENT

Montana receives revenue as a settling party to a Master Settlement Agreement with four original tobacco companies and 34 subsequent companies that ended a four-year legal battle that included 46 states, and six other entities. Montana is eligible for four types of payment: 1) reimbursement for legal costs (received December 1999); 2) five initial payments (two in fiscal 2000 with an additional one per year in fiscal 2001, 2002, and 2003); 3) on-going annual payments; and 4) strategic contribution payments (from fiscal 2008 through 2017). The Master Settlement Agreement places no restrictions on how states are to spend the money. The payments will be received in perpetuity.

REVENUE

The total amount of tobacco settlement funds available to Montana may be affected by a number of adjustments. The two most important are the adjustments for inflation and volume of cigarettes shipped nationally. The amount of Montana's annual share will increase by a minimum amount of three percent or more if inflation is greater than three percent. The amount will decrease if the number of cigarettes shipped nationally decreases and will increase if the number increases. Figure 1 shows the revenue Montana has received through fiscal 2002 and the amounts to be received through fiscal 2005.

DISTRIBUTION

In fiscal 2000, the revenue received from the Master Settlement Agreement was deposited to the general fund. However, due to passage of Montana Constitutional Amendment 35 by the electorate in November 2000, beginning in January 2001, the legislature is required to dedicate not less than 40 percent of tobacco settlement money to a permanent trust fund. Since the legislature has not determined the exact percentage to be distributed to the trust fund, the revenue estimates assume 40 percent. From fiscal 2001 through fiscal 2003, the remainder of the money (60 percent) will continue to be deposited into the general fund. Due to passage of Initiative 146 by the electorate in November 2002, beginning fiscal 2004, 32 percent of the total tobacco settlement money funds tobacco prevention programs and 17 percent funds the Children's Health Insurance Program. The remaining 11 percent of the total settlement money is deposited to the general fund. Figure 1 shows the amounts estimated to be distributed between the general fund, the trust fund, and state special revenue through fiscal 2005.

As stipulated in the Montana Constitution, interest earnings from the tobacco trust are to be distributed: 1) 90 percent for appropriation by the legislature for disease prevention programs and state programs providing benefits,

services, or coverage related to the health care needs of the people of Montana; and 2) 10 percent to the tobacco trust. Money in the tobacco trust can be spent if approved by 2/3 of each house of the legislature. Appropriations of principal, income, or interest from the trust fund cannot be used to replace state or federal money that support tobacco disease prevention programs that existed on December 31, 1999.

Figure 1
Tobacco Settlement and Tobacco Trust Revenues and Distributions

Fiscal Year	Tobacco Settlement Revenue				Tobacco Trust Interest Earnings		
	General Fund	Trust Fund	State Special	Total	State Special	Tobacco Trust	Total
2000 Actual	\$34,804,411	\$0	\$0	\$34,804,411	\$0	\$0	\$0
2001 Actual	15,990,244	10,650,750	0	26,640,994	98,519	71,172	169,691
2002 Actual	18,647,410	12,431,607	0	31,079,017	1,015,407	22,212	1,037,619
2003 Estimate	19,025,400	12,683,600	0	31,709,000	1,566,900	174,100	1,741,000
2004 Estimate	3,104,530	11,289,200	13,829,270	28,223,000	2,217,600	246,400	2,464,000
2005 Estimate	<u>3,182,300</u>	<u>11,572,000</u>	<u>14,175,700</u>	<u>28,930,000</u>	<u>2,927,700</u>	<u>325,300</u>	<u>3,253,000</u>
Totals	<u>\$94,754,295</u>	<u>\$58,627,157</u>	<u>\$28,004,970</u>	<u>\$181,386,422</u>	<u>\$7,826,125</u>	<u>\$839,184</u>	<u>\$8,665,310</u>

DISTRICT COURT ASSUMPTION

OVERVIEW

Prior to July 1, 2002, Montana district courts were primarily funded by the counties, except district court judge's salaries and reimbursements to counties for some costs related to criminal felony cases, which were provided by the state. This changed during the 2001 legislative session when SB 176 was approved, requiring district courts to become a state administered and funded program, along with HB 124, intended to simplify the state and local government funding structure.

Under SB 176, the district courts, with the primary exception of the clerks of court and the provision of office space, became a state-funded function. Beginning in fiscal 2003, the state Judiciary assumed responsibility for oversight and administration of the 22 courts, including approximately 245 additional FTE. Implementation was accomplished through the efforts of the District Court Council, provided in SB 176 (2001 regular session), along with Judiciary staff. During this time and since implementation, the council and branch have encountered issues with SB 176 and continue to advocate that the bill was under-funded.

FUNDING

2003 Biennium

Funding for the 2003 biennium was provided through HB 2 and HB 124. HB 2 provided an \$800,500 biennial appropriation to fund the addition of 8.50 FTE to administer state assumption of district courts. An appropriation was made in HB 124 for the remaining state district court costs of up to \$25.0 million. The fiscal 2003 appropriation was set at \$18.4, million based on 2001 county expenditures for district courts, plus a growth adjustment.

Executive Recommended 2005 Biennium

The executive recommended 2005 biennium budget for district court assumption is \$37.3 million. This is approximately \$17.2 million less than the amount requested by the Judicial Branch, and \$18.9 million more than 2003 biennium funding (2003 biennium funding is only for one year, since state assumption occurred in mid-biennium. Figure 2 shows the biennium to biennium comparison.

Figure 2
District Court Assumption Funding Comparison
2005 Biennium to 2003 Biennium

	2003 Biennium Budget (HB 124)			Executive Proposed 2005 Biennium Budget			Biennium Difference 2005 to 2003
	Fiscal 2002	Fiscal 2003	Biennial Total	Fiscal 2004	Fiscal 2005	Biennial Total	
District Court Assumption							
FTE	0	245	245	245	245	245	0
Personal Services	\$ -	\$ 9,316,475	\$ 9,316,475	\$ 10,778,617	\$ 10,768,670	\$ 21,547,287	\$ 12,230,812
Operating Costs	-	8,804,084	8,804,084	7,434,309	8,330,024	15,764,333	6,960,249
Equipment	-	268,786	268,786	-	-	-	(268,786)
DC ASSUMPTION TOTAL	\$ -	\$ 18,389,345	\$ 18,389,345	\$ 18,212,926	\$ 19,098,694	\$ 37,311,620	\$ 18,922,275

District Court Assumption refers to the personal services costs for all FTE and associated operating costs assumed by the state under district court assumption as outlined in SB 176 (2001 regular session). This includes the operating costs of the District Court judges.

Costs are divided into “fixed” and “variable” costs. Section 61 of SB 176 describes the fixed budget component as costs that are not variable with caseload, including salaries and related operating costs for permanent employees of the court, and contracted professional services.

The variable cost component is those costs that are variable with caseload including but not limited to juror fees, witness fees and expenses, and indigent defense costs. In fiscal 2003, any costs over the appropriated level are the responsibility of the counties. However, under current law, these costs will be completely borne by the state, starting in fiscal 2004. In its original request, the Judiciary included an additional \$17.2 million over the biennium for these costs, beyond the executive funded \$15.1 million. The executive notes that a bill will be introduced to determine responsibilities regarding variable costs, and to address the difference between the agency request and the Executive Budget.

LEGISLATIVE CONSIDERATIONS

Due to delayed implementation of state district court assumption (July 1, 2003), the fiscal 2002 base contains no district court expenditures, and a full biennium cost must be added to the 2005 biennium budget.

Issues

The funding issue primarily pertains to the state’s limited ability to control or predict the variable cost component. In addition, costs not addressed in SB 176 also add to the funding issue for Judicial Branch information technology needs, staff and operating expenses of new judges in Ravalli and Cascade counties, federal grant funded positions, and former county employee accrued annual and sick leave that must be paid when employees leave their state job. Information technology funding is requested in the Executive Budget under the Supreme Court Operations Program, and staff and operating costs of the new judges are included under district court assumption. The Judiciary will try to address the remaining two items without additional funding. Finally, increased costs attributed to pay raises, rent, and the judicial branch pay plan are included in the Executive Budget and have also contributed to a higher fiscal 2005 biennium budget.

Options

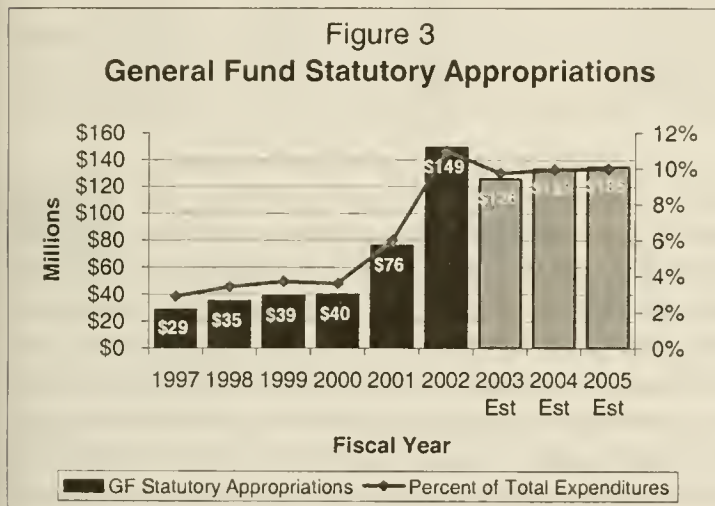
In order to deal with the uncertainties regarding variable costs associated with state assumption of district courts, options are provided.

- Create a state/local partnership for funding variable costs, such as continuing the 65 percent reimbursement mechanism established by the District Court Council for fiscal 2003, or establishing a base amount that counties would pay for variable costs, with the state funding everything above that amount
- Implement cost containment mechanisms, such as setting maximum amounts for attorney fees, investigation and psychiatric examination fees, standardizing the definition of indigent in statute, consolidating staff amongst judicial districts, or providing an incentive to the counties to help control costs by either reducing funds, increasing funds, or through cost sharing
- Defray a portion of court costs through mechanisms used in other states, such as increasing district court fees, charging a minimal administrative or application fee to all indigent defense criminals, including a surcharge on court filings, or including an additional fee on attorney licenses that is deposited into an indigent defense fund

For more information on the issues and options regarding district court assumption, see the corresponding agency narrative for General Government and Transportation beginning on page A-19 of Volume 3.

GENERAL FUND STATUTORY APPROPRIATIONS

Statutory appropriations are a special kind of legislative appropriation. Unlike temporary appropriations that expire in two years (such as those in the general appropriations act), statutory appropriations are, as their name suggests, in statute and are not part of the biennial budgeting process. As such, they are not automatically reviewed by the legislature and are not subject to the priority setting process like temporary appropriations. Since the appropriations are in statute, they remain in place until removed or changed by legislation. The legislature has made various attempts to not lose sight of these appropriations. In 1985, Representative Bardanoue sponsored legislation (HB 12) that required statutory appropriations to be contained in a list of statutory appropriations in 17-7-502, MCA, in order to be valid. That list provides statutory citations for each statutory appropriation. Although there are currently 69 sections listed, some sections have multiple statutory appropriations and each appropriation listed in statute could have multiple appropriations established on the state accounting system. Of these, 16 sections statutorily appropriate general fund. In 1993, Senator Grosfield sponsored legislation (SB 378) that required a review of all statutory appropriations every two years by the Legislative Finance Committee. This requirement was removed by the 2001 legislature.



The significance of statutory appropriations lies not in the number of them, but rather in the amount of money being spent. All appropriations of general fund should be available for review and prioritization by the legislature, especially in times of stagnant growth in general fund revenue and projected present law deficits. Figure 3 shows the amount of general fund spent through statutory appropriations from fiscal 1997 through fiscal 2002 and estimated amounts from fiscal 2003 to 2005. From fiscal 1997 to fiscal 2002 general fund expenditures increased \$120 million and now comprise 11 percent of all general fund expenditures. Figure 4 shows each

individual general fund statutory appropriation that has been included in the general fund balance sheet.

Figure 4
General Fund Statutory Appropriations
Fiscal Years 2003-2005
(in millions)

MCA Cite	Name	Fiscal 2003	Fiscal 2004	Fiscal 2005
10-3-312(1)	EMERGENCY APPROPRIATIONS	\$0.054	\$4.000	\$4.000
15-1-111(6)	LOCAL ASST-PROP RED PA-SA	7.298	6.082	4.865
15-1-121(3)	HB124 COMBINED DISTRIBUTION - SA	76.490	78.832	81.187
15-1-121(3)	HB124 TIFF DISTRIBUION - SA	3.910	3.608	3.608
15-35-108(7)(b)(i)	COOP DEVELOPMENTAL CENTER NMC	0.065	0.065	0.065
15-35-108(7)(b)(ii)	ADD VISION 2005-SA	0.925	1.250	1.250
15-35-108(7)(b)(iii)	ECONOMIC DEVELOPMENT	0.675	1.100	1.100
15-35-108(7)(b)(iv)	ECON DEVELOP STATUTORY	0.175	0.175	0.175
15-35-108(7)(b)(v)	REIMBURSEMENT OF TIFF-SA	0.600	0.600	0.600
17-3-106(2)	CASH MANAGEMENT INTEREST-SA	0.269	0.269	0.269
17-6-101(6)	BANKING CHARGES-SA	1.181	1.172	1.172
17-7-502(4)	TRANS DEBT SERVICE AND ISSUANCE COSTS	1.603	1.482	1.769
17-7-502(4)	TRANSFER TO DEBT SERVICE A/B BOND-SA	17.096	18.272	17.661
19-13-604	PREM TAX-FIRE/POL 19-13-604-SA	5.993	6.209	6.518
19-17-301	PREM TAX-FIRE/POL 19-17-301-SA	1.225	1.317	1.409
19-18-512(1)	PREM TAX-FIRE/POL 19-18-512-SA	0.162	0.164	0.165
19-19-305(1)	PREM TAX-FIRE/POL 19-19-305-SA	0.264	0.266	0.268
19-19-506(4)	PREM TAX-FIRE/POL 19-19-506-SA	0.017	0.017	0.018
19-20-604	TEACHERS GABA 19-20-604-SA	0.659	0.692	0.727
19-3-319	LOCAL GOVERNMENT PERD 19-3-319 -SA	0.404	0.417	0.439
19-9-702	INS PREM TAX-FIRE/POLIC RET 19-9-702-SA	6.886	7.232	7.634

LFD ISSUE

As shown in Figure 4, the largest statutory appropriation of general fund occurs under 15-1-121(3), MCA. For the 2005 biennium, \$167.2 million is expected to be spent for entitlement payments to counties and tax increment financing districts. Because this amount is appropriated in statute, it is not reviewed by the legislature as part of the biennial budgeting process. In essence, it and all other statutory appropriations have priority funding over all general fund programs appropriated in the general appropriations act. In times when the legislature must make difficult budget decisions and prioritize general fund programs to balance the budget, programs funded with general fund statutory appropriations should be considered by the legislature along with all other general fund programs.

As an alternative to funding counties and tax increment financing districts entitlement payments through a statutory appropriation, the legislature could eliminate the statutory appropriation and appropriate the costs in House Bill 2. This would ensure that this expenditure is reviewed and prioritized along with the other general fund programs in House Bill 2, and that the level of funding reflects the current legislature's funding priorities.

LFD ISSUE

Although the statutory appropriations in 15-35-108, MCA, terminate at the end of fiscal 2005, the executive is proposing legislation (LC 460) to extend the termination date to the end of fiscal 2010 for the appropriations to the Department of Commerce. At the appropriation levels proposed in the legislation, the extension will result in an additional \$4.75 million of statutorily appropriated general fund over the five-year period. The money would be spend by the Department of Commerce for: 1) a small business development center; 2) a small business innovative research program; 3) certified communities; 4) the Montana manufacturing extension center at MSU-Bozeman; and 5) export trade enhancement.

The legislature has authorized the office of the Governor to expend \$12.0 million general fund in a biennium whenever an emergency or disaster is declared by the Governor (10-3-312(1), MCA). The executive is requesting legislation (LC 321) to increase this amount to \$25.0 million, a \$13.0 million increase. Recent events funded from this appropriation include floods, storms, terrorism, and wildfires.

Figure 5
General Fund Statutory Appropriation
Expenditures Under 10-3-312(1), MCA

Biennium/Fiscal Year	Total Expenditures	Wildfire Expenditures	Percent
2003 Biennium			
2003*	\$54,182	\$0	0.0%
2002	<u>11,120,638</u>	<u>10,792,329</u>	<u>97.0%</u>
Total	\$11,174,820	\$10,792,329	96.6%
2001 Biennium			
2001	\$9,569,565	\$8,939,421	93.4%
2000	<u>1,650,516</u>	<u>1,108,402</u>	<u>67.2%</u>

As Figure 5 shows, the vast majority of the expenditures have been for wildfires. However, since most wildfires are not emergencies declared by the Governor, costs for the majority of individual wildfires are not paid by this appropriation. Only in extreme cases, such as in fiscal years 2001 and 2002, has the Governor declared wildfires an emergency. Even so, in those years the majority of wildfire costs are not reflected in Figure 5, since Federal Emergency Management Administration funds received by the state to pay wildfire costs were deposited to the general fund and paid from the statutory appropriation

under 10-3-203(2), MCA, rather than under 10-3-312(1), MCA. In addition, statute allows the statutory appropriation in 10-3-312(1), MCA, to be increased if money spent through the appropriation is recovered. Hence, the amount of money spent in a biennium may exceed \$12.0 million.

LFD ISSUE

Although the executive is requesting a statutory increase in the total biennial general fund statutory emergency appropriation to \$25.0 million, no expenditures have been included in the executive's 2005 biennium general fund balance from this appropriation even at the current law level of \$12.0 million. Although emergencies and disasters are difficult to predict, prudent budgeting requires that a portion of general fund be reserved for this contingency. It becomes an even greater necessity if the potential general fund expenditure is increased to \$25.0 million. Governor directed spending reductions or special legislative sessions may be required if events cause the expenditure of the entire \$25.0 million and nothing has been budgeted. The general fund balance projected by the Legislative Fiscal Division includes \$4.0 million of expenditures from this statutory appropriation in each year of the 2005 biennium.

LFD ISSUE

Although unbudgeted wildfire expenditures cause financial difficulties in the Department of Natural Resources and Conservation (see page C-120, Financial Difficulties), increasing the emergency statutory appropriation will not solve these problems unless the statutory requirement for a declared disaster or emergency is removed in the case of wildfire costs. For example, in fiscal 2003 the department spent \$5,514,180 for wildfires and expects to spend \$750,000 more by the end of the fiscal year. None of these costs are eligible to be paid with the emergency statutory appropriation because a disaster or emergency has not been declared.

GENERAL FUND NON-BUDGETED TRANSFERS

The Montana Constitution requires that all money paid out of the state treasury, except interest paid on the public debt, be done with an appropriation. However, the state treasury consists of numerous funds and, with proper authorization, money may be transferred from one fund to another without an appropriation. This results in less money in one fund for the programs it funds and more in another. Like statutory appropriations, these transfers and their authorizations are in statute and are not part of the biennial budgeting process, yet they affect the amount of money available for the legislature to appropriate for specific programs.

Over the last two biennia, an increasing amount of money has been transferred out of the general fund to other funds for non-general fund programs.

As illustrated in Figure 6, this amount has grown from \$0 in fiscal 1999 to \$19 million in fiscal 2002, or nearly 1.2 percent of total general fund expenditures, and is estimated to be nearly \$32 million in the 2005 biennium. These transfers reduce the amount of money in the general fund that is available for general fund programs and increase the amount available for other non-general fund programs. The programs funded from these transfers should be subject to the same review and prioritization as any other general fund programs to ensure proper funding of the legislature's priorities.

Figure 6
General Fund Non-budgeted Transfers

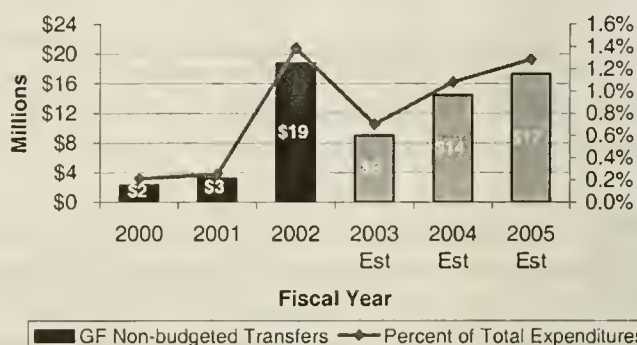


Figure 7 shows each non-budgeted general fund transfer that has been included in the general fund balance sheet.

Figure 7 General Fund Non-budgeted Transfers Fiscal Years 2003-2005 (in millions)				
MCA Cite	Name	Fiscal 2003	Fiscal 2004	Fiscal 2005
<u>House Bill 124</u>				
15-1-122	HB 124 - Adoption services	\$0.037	\$0.040	\$0.044
15-1-122	HB 124 - to DOT (amended by HB5 SS)	0.075	2.961	3.005
15-1-122	HB 124 - Junk vehicle titling fee	0.453	0.463	0.463
15-1-122	HB 124 - Junk vehicle registration fee	1.030	1.055	1.055
15-1-122	HB 124 - Weed registration fee	1.591	1.629	1.629
15-1-122	HB 124 - Weed fee OHV FILT	0.023	0.027	0.026
15-1-122	HB 124 - OHV decal fee	0.119	0.122	0.122
15-1-122	HB 124 - OHV duplicate decal fee	0.000	0.000	0.000
15-1-122	HB 124 - Watercraft decal fee	0.130	0.133	0.133
15-1-122	HB 124 - Snowmobile decal fee	0.121	0.124	0.124
15-1-122	HB 124 - Snowmobile duplicate decal fee	0.000	0.000	0.000
15-1-122	HB 124 - Parks recreational fee	0.218	0.224	0.224
15-1-122	HB 124 - Watercraft FILT 20%	0.249	0.292	0.289
15-1-122	HB 124 - Highway patrol retirement	0.317	0.324	0.324
15-1-122	HB 124 - DOT senior transportation	0.321	0.329	0.329
15-1-122	HB 124 - Veterans license plates	<u>0.152</u>	<u>0.156</u>	<u>0.156</u>
Subtotal		\$4.835	\$7.878	\$7.923
<u>Other</u>				
15-35-108	Research & commercialization (HB 5 SS)	\$3.165	\$3.650	\$3.650
17-3-240	To mineral impact account (HB 226)	<u>1.044</u>	<u>2.934</u>	<u>5.745</u>
Subtotal		\$4.209	\$6.584	\$9.395

GENERAL FUND CASH POSITION

The projected general fund ending cash position for fiscal 2003 is at a historical low point. The ending fund balance of the general fund is made up of two major components, the biggest portion is cash and the remainder is in the form of accruals. Accruals are simply an estimate of expected revenues and disbursements during the fiscal year, where payment is expected within 60 days of the next year. The importance of the cash position is significant, and sufficient cash is required to pay the state's budgeted obligations. Often, to bolster monthly general fund cash balances, the Department of Administration (DOA) seeks authority from the Board of Examiners (BOE) to issue Tax and Revenue Anticipation Notes (TRANS). Because of the reduced level of revenues in fiscal 2002 and the anticipated reduced levels in fiscal 2003, the DOA issued \$93.0 million in TRANS in October 2002.

There are certain requirements that must be met before TRANS can be issued. Most importantly, TRANS must be paid in full prior to the end of the fiscal year of issue (17-1-204, MCA). Additionally, the debt is pledged and backed with the full faith and credit and taxing power of the state. According to 17-1-204 (2), MCA, *"if there are insufficient funds in the general fund to pay the notes and interest on the notes when due, the department shall transfer available funds from any fund of the state, except pension trust funds, to the general fund to pay the notes and interest."*

In estimates provided by the DOA, the ability to pay off the fiscal 2003 TRANS with general fund monies may not be possible without borrowing from some other state account. At this time the general fund ending balance for fiscal 2003 is estimated at \$4.4 million. Of that balance, there is an approximate \$5.0 million differential between the ending fund balance and the cash balance of the general fund. This suggests that at the end of fiscal 2003, the general fund will have a negative \$0.6 million ending cash balance and will not have sufficient cash to repay the TRANS. Consequently, the executive has proposed two bills to solve the cash dilemma. The first proposal is to adjust the accounting methodology for oil and gas production taxes. This proposal will only provide added accruals and will not solve the immediate cash shortage. The second proposal is to transfer cash from the State Fund to the general fund. If these proposals are not approved by the legislature, the general fund could end the year in a negative cash position, and the DOA would be required to transfer funds from some other account to pay back the TRANS debt.

In November 2002, the Legislative Finance Committee sought legal advice on the constitutionality of paying the TRANS by borrowing monies from other state accounts, given the provisions of the Montana Constitution, Article VIII, Section 8. This article states that, *"No state debt shall be created to cover deficits incurred because appropriations exceeded anticipated revenue."* In his decision, Greg Petesch, Chief, Legislative Legal Counsel, determined that, "The need for the state general fund to borrow money from other state funds in order to pay the notes as authorized in 17-1-204 and 17-2-105, MCA, does not create additional debt, but merely changes the form of evidence of the existing authorized debt." In other words, the state could use money from other funds, with exception of pension funds, to repay the TRANS, as long as any demands on the fund are not impaired.

The intent of the issuance of TRANS are clearly listed in the compiler's comments associated with Title 17, Chapter 1, part 2. The ability to issue TRANS to provide cash for monthly cash flow deficits was first used in 1979. At that time, the legislature faced a situation similar to that of fiscal 2002. Of particular importance is Section 2 of the compiler's comments which indicates the intent of TRANS was to curtail the need for borrowing from other state funds. When the TRANS process was established,

clearly the legislature wanted a method for mitigating monthly cash flow problems without utilizing monies from other funds.

At the beginning of fiscal 2003, the DOA sought authorization from the BOE to issue \$93.0 million in TRANS. This action was taken to provide adequate monthly cash flow and to remove the necessity of borrowing from other funds. At the end of fiscal 2003, current estimates suggest there will not be enough cash to repay the TRANS without borrowing from other state funds. Furthermore, the continued problems with cash flows will likely necessitate the issuance of another large TRANS issue in fiscal 2004.

The legislature may want to consider whether a statutory change is necessary to better reflect legislative intent and protect state financial stability.

LOCAL GOVERNMENT ASSISTANCE RESTRUCTURING

In 2001, the legislature passed HB 124, which substantially changed the financial relationship between state and local governments.

Beginning in fiscal 2002, HB 124 reallocated revenue to the state that had formerly gone to local jurisdictions. The revenues reallocated were state mandated vehicle taxes and fees, video gaming taxes, financial institution taxes, alcoholic beverage taxes, and other smaller sources.

HB 124 replaced the local revenue by creating entitlements for counties and cities. In fiscal 2002, the level of entitlement to each county and city was the amount of revenue lost by each entity based on actual receipts from these revenue sources in fiscal 2001. In addition, the entitlements included the amount of SB 184 reimbursements each jurisdiction received in fiscal 2001. SB 184 reimbursements were payments from the state to local jurisdictions for reductions in the property tax base in each jurisdiction due to several pieces of legislation passed during the 1999 legislature. The property tax base reductions included reductions in tax rates for business equipment, electrical generating and telecommunications property, livestock, and oil and gas production. Future payments of SB 184 reimbursements to local jurisdictions were to remain fixed over time.

HB 124 contained a procedure that defines a growth factor to be applied to entitlements in the future. It was intended that HB 124 entitlements were to grow 3 percent for cities, 2.3 percent for counties and 2.65 percent for consolidated governments in fiscal 2002 and 2003. However, HB 124 mistakenly contained a growth rate of 3 percent for entitlements to all jurisdiction types. HB 18, passed during the August 2002 special session, reduced entitlements in fiscal 2003 to account for the higher than intended growth rates for counties and consolidated county city governments contained in HB 124.

Growth factors in future HB 124 entitlements in fiscal 2004 and 2005 are based on the actual growth in Montana's total personal income and gross state product. Growth rates over the prior four years for which data is available for each data series is averaged. Cities are entitled to a growth factor of 70 percent of the average growth of the combined series. For counties, the growth factor is 54 percent while consolidated governments is 62 percent of the combined services.

Figure 8 shows the calculation of the growth rate for each local government type for fiscal 2004 and 2005. Each entitlement will increase by approximately 10 percent more than in each year of the 2003 biennium.

Figure 8
Financial Data for Calculation of HB 124 Entitlement Growth
for Cities and Counties
Fiscal 2004 and 2005

Montana Gross State Product Calendar Year		Montana Personal Income Calendar Year	
Millions		Millions	
1996	\$ 18,074	1997	\$ 17,726
1997	18,907	1998	18,942
1998	19,971	1999	19,380
1999	20,564	2000	20,678
2000	21,777	2001	21,673
Average Growth			
Gross State Product		Personal Income	
Period		Period	
1996-1999	4.40%	1997-2000	5.27%
1997-2000	4.82%	1998-2001	4.59%
Fiscal 2004		Fiscal 2005	
Average Growth *	4.83%		4.71%
City Growth Rate			70%
County Growth Rate			54%
Consolidated Growth Rate			62%
Fiscal 2004		Fiscal 2005	
City Growth Factor	3.38%		3.30%
County Growth Factor	2.61%		2.54%
Consolidated Growth	3.00%		2.92%

* Average Growth for fiscal 2004 is Gross State Product growth for 1996-1999 averaged with Personal Income growth for 1997-2000. Average growth for fiscal 2005 is the same with period moved forward one year.

In total, entitlements for cities, counties, and consolidated governments will be \$8.9 million (5.9 percent) higher in the 2005 biennium than in the 2003 biennium. These rates of growth exceed the expected rate of growth in state general fund revenues for the 2005 biennium. The executive has not recommended any change in entitlement growth rates.

LFD
ISSUE

The language in 15-1-121, MCA states that the department must make the calculations of growth in Montana gross state product and total personal income by October 1, 2004 – for growth rates in the following biennium. This would mean that the above calculations would apply to the 2007 biennium, leaving the growth rates for the 2005 biennium unspecified. This is because October 1, 2004, is already in the 2005 biennium. A simple amendment to statute would be to change the date by which the department must make its growth calculations to October 1, 2002. The Executive Budget entitlement calculations are based on the October 1, 2002, date.

MENTAL HEALTH SERVICES: INTERIM STUDY

HJR 1 passed by the 2001 legislature, directed the Legislative Finance Committee (LFC) to study public mental health issues. As directed by HJR 1, the LFC established a subcommittee with membership from the Children and Families Interim Committee, the Legislative Audit Committee, the State Administration and Veterans' Affairs Interim Committee, and the Law and Justice Interim Committee.

The LFC directed the subcommittee to narrow the focus of the study and to focus on areas outside the scope of other entities working on mental health issues, including the Mental Health Oversight Advisory Council and the Multi Agency Children's Committee, dealing with integration of services for children with intensive needs. The study was designed to review issues and topics that:

- Were important to the mental health system and "do-able" within the study time frame
- Would complement but not duplicate what other players are considering
- Would identify potential changes to mental health services that are compatible with any regional system design
- Would provide meaningful recommendations to the Legislative Finance Committee (LFC) to forward to the 2003 legislature

The study focused on the commitment process to the Montana State Hospital and to community services, and transitions to intensive services in the community.

The HJR 1 Subcommittee recommended five bill drafts for consideration by the LFC and that the LFC review options to cap the Montana State Hospital (MSH) population at its November 2002 meeting. The LFC approved all five bills.

PROPOSED LEGISLATION

The five bills recommended by the LFC are summarized as follows:

- A bill to adopt an affirmative definition of "mental disease or defect" in response to the Montana Supreme Court case *State v. Wooster*. In that case, the court adopted the New York definition since Montana statute was silent
- A bill to refine the statutory distribution of the alcohol tax allocated to DPHHS. The subcommittee recommended that 20 percent of the proceeds be allocated to the state approved chemical dependency programs and 6.6 percent be used for services to treat persons who have a serious and disabling mental illness and who are chemically dependent. The August 2002 Special Session temporarily diverted the state approved program share of the alcohol tax to match Medicaid costs for mental health services. Effective June 30, 2002, without changes recommended by the subcommittee, state approved programs would receive alcohol tax proceeds that remained after the legislature had made its appropriations from the proceeds allocated to DPHHS
- A bill placing a limit on the period of confinement for those found not guilty by reason of insanity following language from Utah. The language would limit the period of confinement to no longer than would have been imposed if the person were convicted of the crime for which he or she was charged
- A bill regarding an involuntary mental illness commitment to the community. The bill specifies that a community commitment be for a period of three months unless there has been a previous involuntary commitment for inpatient treatment for which a community commitment may be made for no more than six months. In order for a previous inpatient treatment to be admissible in a community commitment determination, a judge must find

admission of such evidence is relevant to the criteria of predictability and outweighs the potentially prejudicial effects of such evidence

- A bill to statutorily authorize counsel, after consultation with the client and when determined to be in the client's best interest, to authorize expedited access to treatment in order to reduce the threat of injury to self or others. This is proposed in response to the recent K.G.F. decision by the Montana Supreme Court.

CAPPING THE MSP POPULATION

The HJR 1 Subcommittee heard testimony from Department of Public Health and Human Services (DPHHS) staff about proposals to cap the MSH population at its final meeting. One suggestion was to contract with Behavioral Health Inpatient Facilities (BHIFs), which was included in the revised Executive Budget published in November 2002. Since the proposal was not brought to the subcommittee prior to the last meeting, it was not reviewed by the subcommittee.

FUND BALANCE ADEQUACY / RESERVES

Experts indicate that recovery from the recent economic downturn will be slow. Events of the past 18 months have shown that the state's fiscal stability is not immune to economic and political changes, globally and nationally. General economic factors that have had an impact resulting in much slower growth in state revenues during fiscal 2003 include significantly reduced values in equity markets and lower interest rates. The economic outlook for the 2005 biennium remains uncertain.

Attaining general fund budget stability means more than setting appropriations equal to anticipated revenues, with a positive ending fund balance serving as a safety net. The adequacy of the state fund balance can signify the difference between whether or not the state is forced to confront the unpleasant consequences of fiscal instability.

Montanans are all too familiar with the consequences of general fund balance inadequacy. In the late 1980's and early 1990's, the state general fund experienced a deficit between revenues and disbursements. Much of the growth in the disbursement rate is a result of natural growth in expenditures due to inflation and/or caseload and enrollment increases, as well as supplemental spending for such contingencies as fire suppression. Revenue growth in the state has not always kept pace with expenditure growth. During the current 2003 biennium, actual revenue growth has been well below forecasts, primarily because of reduced income tax collection and lower interest rates, circumstances that could not be predicted when the 2003 biennium budget was being approved.

The Fifty-seventh Legislature adjourned from the 2001 regular session with a projected 2003 biennium general fund ending balance of \$54 million (2.3 percent of biennial appropriations). While revenues came in strong for the first months of the biennium, in November 2001 the Legislative Fiscal Division reported a significant downturn in general fund revenues. By the end of the first fiscal year, revenue estimates for the biennium had dropped \$153 million. In June 2002, the Governor directed statutory spending reductions of \$23 million in fiscal 2003 and called the legislature into special session to close the remaining gap to achieve an acceptable ending fund balance reserve. The legislature adopted \$59 million in budget balancing actions and adjourned with a \$40 million projected balance. Revenues still remain unstable as the Fifty-eighth Legislature prepares for deliberation of the 2005 biennium budget.

Recognizing that budgetary imbalances occur, the state can either take a reactive or a proactive approach. During the 1993 and 1995 biennia, the state held three special legislative sessions to deal with budget shortfalls. Another occurred in August of 2002. Although special sessions allow lawmakers the ability to address issues relative to revenues and expenditures, special sessions can cost the taxpayers approximately \$47,000 per day. The need for special sessions is also closely scrutinized by the national agencies that rate the state's debt. Rating agencies also use a state's general fund balance as a percent of revenues as one of the key financial indicators for credit analysis.

Again from a reactive stance, budgetary fluctuation can be temporarily resolved through spending reductions. In accordance with 17-7-140, MCA, the Governor can authorize spending reductions: *"...in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1 percent of all general fund appropriations during the biennium."* Essentially, the executive branch assumes control of the budget decision-making process by implementing and prioritizing spending reductions. Further, budgetary imbalances can be addressed only from one side of the equation -- expenditures. This means that legislative priorities could potentially get lost in the process.

Because of the cost and disadvantages of taking a reactive approach to budget imbalances, a more effective method may be to approach these issues proactively through provision of adequate fund balance reserves. National fiscal experts such as the National Conference of State Legislatures (NCSL) recommend a reserve fund balance of three to five percent of total appropriations or revenues. Because Montana's budget is implemented on a biennial basis -- resulting in considerably more risk than an annual budgeting process -- the three to five percent should be applied to biennial totals. At a minimum, the budget process should include a general fund ending fund balance of 2.5 percent of total biennial appropriations or revenues. For Montana, with a total general fund budget of \$2.6 billion, this equates to a \$65.0 million ending fund balance. The revenue volatility during the current biennium might suggest that a higher reserve would be more prudent. The Executive Budget proposes an ending fund balance of approximately \$50 million, or 1.9 percent.

The provision of an adequate general fund balance is essential to achieving a sound financial foundation. The level of fund balance reserves must be sufficient to offset the volatility of revenues and the potential for unforeseen expenditure increases. It is even more important since Montana is one of only four states that does not have a rainy day fund provision. To this end, the legislature will again need to determine what amount of ending fund balance is sufficient to ensure budget stability.

ACCRUALS

The following figure shows all "A" accruals booked by agencies at fiscal 2002 year end, along with the amount paid as of October 20, 2002. Accruals are items that were expended by agencies in fiscal 2002 for materials/services that had not been received by the end of the fiscal year. In many cases, the materials or services are either cancelled or never received, and the expenditure is never completed. Yet the expenditure has been included in the base budget used to develop the 2005 budget, and is not a valid base increase.

LFD staff has recommended that \$240,000 general fund and \$2,400,000 total funds in the Department of Public Health and Human Services could be eliminated. In addition, the Office of Public Instruction accrual is a mistake and can be removed. These reductions will be considered by the appropriate joint appropriations subcommittees.

Staff continues to monitor many of the accruals that have yet to be paid. Updates will be provided to the legislature during budget establishment as necessary.

Figure 9				
"A" Accruals in Agency Budgets				
Fiscal 2002 as of Fiscal Year End				
Section/Agency	Fiscal 2002		Paid as of	
	General Fund	Other Funds	20-Oct	
<u>Section A</u>				
Legislative Branch	\$ 216,432	\$ 497	\$94,358	
Consumer Counsel	0	0	0	
Judiciary	20,880	0	20,880	
Mt. Chiropractic	0	0	0	
Governor's Office	364,606	0	84,806	
Secretary of State	0	0	0	
COPP	0	0	0	
State Auditor	0	0	0	
Transportation	0	8,500,437	4,688,341	
Revenue	0	0	0	
Administration	27,309	33,518	11,770	
Appellate Defender	0	0	0	
<u>Section B</u>				
PHHS	380,709	2,689,407	288,290	
<u>Section C</u>				
Fish, Wildlife, Parks	4,815	540,387	197,689	
Env. Quality*				
Livestock	0	0	0	
DNRC	471,154	1,122,009	783,312	
Agriculture	114,841	1,227,046	246,973	
Commerce	60,108	1,308,719	349,071	
<u>Section D</u>				
PSC	0	2,711	2,711	
Crime Control	7,776	33,624	22,547	
Justice	486,613	54,989	115,776	
Corrections	0	93,376	93,376	
Labor/Industry	0	187,355	134,596	
Military Affairs	153,616	93,830	114,844	
<u>Section E</u>				
OPI	1,500	0	0	
Board of Public Ed	0	0	0	
MSDB	0	0	0	
MUS	0	0	0	
Arts Council	0	8,575	0	
Library Commish	2,522	96	2,618	
Historical Society	<u>6,870</u>	<u>111,597</u>	<u>44,662</u>	
Total	<u>\$ 2,319,751</u>	<u>\$ 16,008,173</u>	<u>\$ 7,296,620</u>	

UNIFIED COMPUTER BUDGET

This section discusses the requirement for a “unified computer budget” as provided for in 17-7-123(1)(e)(iii), MCA. This statute provides that requests for funding for information technology (IT) expenditures be presented in a summary form. Therefore, information technology requests are reflected in two ways: 1) as part of the specific agency and program requests in Volumes 3 and 4 of the *Legislative Budget Analysis*; and 2) in a summary of “significant” decision packages in the *2005 Biennium Executive Budget* and as discussed below. This section provides background, a summary of the “significant” IT decision packages, and a discussion of a related issue for consideration by the legislature.

BACKGROUND

The use of technology in the everyday operations of state government has grown, and almost every announcement of new hardware or software is designed to provide improved government services and to enhance the ability of workers to perform. Consequently, information technology is an area of expenditure in state government that has seen considerable growth in recent years. Budgets for various technology-related items have demanded a larger and more significant share of the overall budget. It has become increasingly difficult for legislators to sort through this category of the budget and make decisions that represent a clear path to the most efficient and effective use of information technology and state funds. While there have been various efforts over the years to develop policies and guidelines and to coordinate the application of technology within state government, the legislature has continued to experience difficulty in “getting their arms around” this budget area.

The 1999 legislature took a couple of steps that were intended to solve this dilemma. First, in HB 2, it required the Office of Budget and Program Planning (OBPP) to “*provide to the legislature no later than November 15, 2000, by agency and program, a report showing information technology-related actual and adjusted expenditures in fiscal year 2000 and budgeted amounts for each year of the 2003 biennium.*” Second, in HB 2, it established an interim study of information technology management and policies, and the presentation of budget requests in a form that better enables the legislature to review and make policy decisions for this area of budget and policy. A subcommittee of the Legislative Finance Committee (LFC), with aid from the Legislative Fiscal Division (LFD) and executive branch staff, performed the interim study. A final report was issued September 15, 2000 and provided recommendations for legislation to address information technology (IT) governance changes. This report is available upon request from the Legislative Fiscal Division.

In response to the LFC interim study, the 2001 legislature enacted SB 131, which continued the requirement for the executive to provide a summary of information technology budget requests. The legislation went much further by reorganizing IT administration and planning, establishing a Chief Information Officer (CIO) position to oversee the IT activities from a statewide perspective, creating an information technology board, and setting forth legislative policy guidelines. The legislation also provided a direct link between IT planning and budgeting, by requiring a unified information technology summary as part of the Executive Budget.

During the interim, the office headed by the newly appointed CIO developed the first ever statewide IT plan, and agencies prepared agency IT strategic plans under the statewide strategies and newly developed IT requirements. Agency budget submissions for the 2005 biennium are, for the first time, linked to IT strategic planning.

SUMMARY OF INFORMATION TECHNOLOGY REQUESTS FOR THE 2005 BIENNIUM

Figure 10 lists the most “significant” IT-related decision packages (i.e., IT-related decision packages with requests of \$300,000 or more for the biennium) as identified in the “unified information technology summary” of the 2005 Biennium Executive Budget. These present law adjustments and new proposals total \$20.9 million for the biennium, and represent a large majority of all IT-related HB 2 requests. Brief descriptions of each can be found in the respective agency sections in Volumes 3 and 4 of this publication. It should be made clear that this summary does not incorporate the IT-related budgets included in the base budgets for the various state agencies or IT-related budget requests that are not classified as significant (IT program changes in excess of \$300,000 for the biennium).

Figure 10 Unified Computer Budget Significant IT-Related Decision Packages (>\$300,000 Total Cost) 2005 Biennium							
Agency	Decision Package	Ref. No.*	General Fund	State Special	Federal Funds	Proprietary Funds	Total
Judiciary	Judicial Branch Info Technology	NP 8001	\$0	\$3,408,917	\$0	\$0	\$3,408,917
Secretary of State	Information Technology Plan	NP 2	0	0	0	1,055,000	1,055,000
Justice	Motor Vehicle Registration Automation	NP 8003	0	3,900,000	0	0	3,900,000
Environmental Quality	One Stop Grant - Biennial Appropriation	PL 88	0	0	500,000	0	500,000
Transportation	Integrated Financial Systems	NP 102	0	0	8,000,000	0	8,000,000
	Traffic Data Processing Software	PL 5004	0	98,376	301,624	0	400,000
Revenue	Additional Funding for POINTS Maintenance	NP 210	600,000	0	0	0	600,000
	Discontinue POINTS Phase II **	NP 210 & NP 809	-386,459	0	0	0	-386,459
Administration	Public Safety Communications	NP 701	0	0	2,250,000	0	2,250,000
	Statewide Centerline Roadway GIS	NP 702	0			518,449	518,449
	Project Management Support	NP 703	0	0	0	630,503	630,503
	Total		<u>\$213,541</u>	<u>\$7,407,293</u>	<u>\$11,051,624</u>	<u>\$2,203,952</u>	<u>\$20,876,410</u>

Although the total shown in Figure 10 is about 25 percent greater than the total listed for the previous biennium (2003 Biennium Legislative Budget Analysis), the general fund amount requested is considerably less than for the 2003 biennium. General fund decision packages for the 2005 biennium reflect a \$0.2 million increase, while 2003 biennium “significant” decision packages showed a \$2.3 million increase in general fund spending, a significant swing toward efforts to balance the 2005 biennium budget.

**LFD
ISSUE**

The summary of information technology requests as submitted in the Executive Budget, although apparently consistent with legislative direction, lacks sufficient data to adequately analyze this specific area of state expenditures. The summary includes only the largest of the IT decision packages, with no comparison to the base IT budget. Over the years, the legislature has struggled a great deal in trying to understand the magnitude of IT costs, the diversity of applications, and the common issues of budgeting for agency IT costs. The efforts of the Legislative Finance Committee during the 1999-2000 interim and the 2001 legislature (SB 131) to redefine how IT budgets are reviewed are lost if adequate information is not provided. The legislature should see the whole picture, not just a fraction of the IT spending picture. The 2003 biennium Executive Budget provided considerably more detail than this recent submission for the 2005 biennium. The 2003 biennium information reflected total state IT expenditures of \$165.5 million in fiscal 2000. HB 2 IT expenditures were \$77.9 million. This shows that the decision packages listed in Figure 10 and adding up to \$20.9 million are a very small fraction of total state IT costs. The legislature may wish to clarify that the IT budget request summary should include the base budget requests as well as the present law and new proposal decision packages. This clarification would require a statutory change to language in 2-17-526 and 17-7-111(4)(b), MCA, and possibly to 17-7-123(1)(e)(iii), MCA.

OTHER MAJOR FUNDS

HIGHWAYS STATE SPECIAL REVENUE ACCOUNT DECLINING WORKING CAPITAL BALANCE

The 2003 legislature is faced with a declining working capital balance in the highways state special revenue account. The account is projected to end fiscal 2005 with a working capital balance of \$10.2 million, which is down from a \$51.4 million balance at the end of fiscal 2002. Projections indicate that expenditures will exceed revenues by \$21.0 million in the 2005 biennium, with the imbalance continuing in future biennia.

Revenues to the account, which are from highway user fees primarily comprised of motor fuel tax collections and gross vehicle weight fees, are expected to increase at an average annual growth rate of 0.7 percent. Revenue growth is not expected to keep pace with rising expenditure levels and inflationary increases associated with highway construction and related programs. The inelasticity of program revenues has contributed to the chronic deficit spending imbalance of this program.

Deficit spending is a key contributor to the projected decline in working capital balance. Without actions to bring revenue and expenditure growth rates more in line with each other, the account is projected to continue to decline and could begin to impact the ability of the Department of Transportation to provide for the needs of the state highway infrastructure.

This issue is presented in more detail in the Department of Transportation budget discussion in Volume 3, General Government and Transportation Section; page A-104.

RESOURCE INDEMNITY TRUST – FUND BALANCE SHORTFALLS

The Montana Constitution (Article IX, Section 2) requires the existence of the Resource Indemnity Trust (RIT) and states, "*The principal of the resource indemnity trust shall forever remain inviolate in an amount of one hundred million dollars (\$100,000,000) guaranteed by the state against loss or diversion.*" In February of 2002, the Governor certified that the balance of the RIT trust had exceeded the \$100.0 million threshold. Consequently, the trust no longer receives revenue. However, interest earnings are used as a funding source for several funds discussed below.

The executive is recommending a number of changes in the distribution of proceeds and interest that have a major impact on accounts that receive all or a portion of their revenues from these sources. The following discusses the accounts and attendant issues. For a further discussion, see the narrative for the Department of Natural Resources and Conservation beginning on page C-123 of Volume 4.

Figure 11 shows the first three of four elements of RIT as proposed by the executive. The first element shows the RIT revenues and trust balance using the Revenue and Transportation Committee (RTIC) projections for fiscal years 2003, 2004, and 2005. As of 2002 fiscal year end, the RIT trust had a balance of approximately \$102.1 million.

Figure 11
Resource Indemnity Trust (RIT): Interest Earnings, and Related Expenditure Accounts
2005 Biennium Projections (Including Executive Proposals and Appropriation Requests)

1

RIT Revenues (RTIC estimates)	<u>Fiscal 2002</u>	<u>Fiscal 2003</u>	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>
Projected Beginning Balance FY 2003		\$102,065,653	\$100,000,979	\$100,000,979
Fund Balance Allocations/Transfers				
DNRC Funding Switch with General Fund		(1,000,000)		
Weed Eradication		(300,000)		
Water Treatment (\$540K)		(540,000)		
Clark Fork River Study		(120,000)		
Subdivisions, Cons. Dist., Irrigation Grants		<u>(100,000)</u>		
Total Deposits/Legislative Changes		(\$2,060,000)		
RIGWAT Coal, Oil, Natural Gas Proceeds		(4,675)		
RIT Trust Balance	\$102,065,653	<u>\$100,000,979</u>	<u>\$100,000,979</u>	<u>\$100,000,979</u>

2

	<u>Fiscal 2003</u>	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>	<u>Biennium Total</u>
RIGWA and Oil and Gas Tax (RTIC estimates)	\$1,480,000	\$3,260,000	\$3,236,000	\$6,496,000
RIGWA Tax	\$1,080,000	\$1,055,000	\$1,062,000	\$2,117,000
<u>Statutory Allocations -- RIGWA</u>				
Libby Clean-up Debt Service (Proposed in IIB 10)		\$700,000	\$700,000	1,400,000
Groundwater Assessment Account-direct (02289)	366,000	355,000	362,000	717,000
Reclamation & Development-50% of Remainder (02458)	357,000	0	0	0
Natural Resource Worker Scholarship	0	0	0	0
Orphan Share Account- Remainder of RIGWA (02472)	<u>357,000</u>	0	0	0
TOTAL RIGWA STATUTORY ALLOCATIONS	1,080,000	1,055,000	1,062,000	2,117,000
Applicable Oil and Gas Tax	\$400,000	\$2,205,000	\$2,174,000	\$4,379,000
<u>Applicable Portion of Oil and Gas</u>				
Coal Bed Methane Protection	400,000	400,000	400,000	800,000
General Fund	0	1,805,000	1,774,000	
Reclamation & Development-50% of Remainder (02458)	0	0	0	0
Orphan Share Account-50% of Remainder (02472)	0	0	0	0
TOTAL Oil and Gas STATUTORY ALLOCATIONS	<u>400,000</u>	<u>2,205,000</u>	<u>2,174,000</u>	<u>4,379,000</u>
TOTAL RIGWA & OIL AND GAS ALLOCATIONS	<u>\$1,480,000</u>	<u>\$3,260,000</u>	<u>\$3,236,000</u>	<u>\$6,496,000</u>

3

	<u>Fiscal 2003</u>	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>	<u>Biennium Total</u>
RIT Interest Earnings (RATC estimates)	\$7,377,000	\$7,379,000	\$7,380,000	\$14,759,000
Priority Statutory Allocations of Interest				
Environmental Contingency Account (02107)**	0	(175,000)	0	(175,000)
Oil & Gas Prod. Damage Mitigation Account (02010)***	0	(50,000)	0	(50,000)
Water Storage Account (02216)	0	(500,000)	0	(500,000)
Groundwater Assessment Account-Direct (02289) ****	(300,000)	(300,000)	(300,000)	(600,000)
MSU-Northern Statutory Appropriation (02272)	(240,000)	(240,000)	(240,000)	(480,000)
Fish, Wildlife, and Parks -- Future Fisheries (02022)	(350,000)	(250,000)	(250,000)	(500,000)
Renewable Resource Grant & Loan Program (02272)	(2,000,000)	(2,000,000)	(2,000,000)	(4,000,000)
Reclamation & Development Grants (grants) (02458)	<u>(1,200,000)</u>	<u>(1,200,000)</u>	<u>(1,200,000)</u>	<u>(2,400,000)</u>
Total Allocations	(\$4,090,000)	(\$4,715,000)	(\$3,990,000)	(\$8,705,000)
Amount Available for Further Distribution	\$3,287,000	\$2,664,000	\$3,390,000	\$6,054,000

Since the RIT reached the constitutionally mandated level of \$100.0 million, the excess trust balance was available for transfer and appropriation. In the order of priority, the legislature transferred and appropriated: 1) \$1.0 million for a funding switch in DNRC; 2) \$300,000 for the purpose of weed

eradication; 3) \$540,000 for the purpose of purchasing securities for water treatment at the former Zortman and Landusky mines; 4) \$120,000 for a Clark Fork River study; and 5) up to \$100,000 for conservation and irrigation district grants. After these transfers, the RIT trust is estimated to be \$100.0 million.

The second element shows the statutory allocations of resource indemnity and groundwater assessment taxes (RIGWA) and the applicable portion of the oil and gas tax. The RIGWA tax and the applicable portion of oil and gas taxes are distributed to a number of natural resource accounts. The following describes the current law revenue sources of the main RIT funds, and is shown in Figure 11:

- RIGWA – The state imposes a resource indemnity and groundwater assessment (RIGWA) tax on the gross value of coal, as well as most minerals, excluding metals and oil and natural gas. Beginning in fiscal 2003, the first \$366,000 of the RIGWA tax is deposited into the groundwater assessment account. Of the remainder, 50 percent is deposited into the reclamation and development account (R&D) for the purpose of making grants to be used for mineral development reclamation projects. Starting in fiscal 2004, an amount is deposited into an account for natural resource worker scholarships to bring the total in that program to \$150,000. All remaining funds are deposited into the orphan share account. The money in the orphan share account is available to the department by appropriation and must be used to reimburse remedial action costs and to pay costs incurred defending the orphan share.

The executive is proposing the following changes that affect the distribution of RIGWA:

- Legislation proposed by the Office of Budget and Program Planning would provide an EPA funding match through the issuance of up to \$9.0 million in bonds (authorized under 75-10-623, MCA) that would be used to clean up the Libby and Troy areas
- Based upon Revenue and Transportation Interim Committee revenue projections, \$1.0 million will be generated from RIGWA. If the first \$700,000 of the RIGWA tax was used for debt service, the reclamation and development, groundwater assessment, and orphan share accounts would have reduced projected ending fund balances. Further, SB 322, passed during the 2001 legislative session, modified 15-38-106, MCA, and created a natural resource workers education scholarship program. Based upon the level of RIGWA revenue projections, it is unlikely that this scholarship program would continue to receive distributions and no funds would go to the R&D or orphan share accounts
- Applicable portion of oil and gas taxes – A portion of oil and natural gas production taxes are distributed to the main RIT natural resource funds. 15-36-324 (9)(c), MCA, directs the first \$400,000 into the coal bed methane protection account. The remainder of the applicable portion of oil and gas proceeds are split, with 50 percent going to the R&D fund and 50 percent to the orphan share fund.

The executive is proposing the following change that affects the distribution of the applicable portion of oil and gas taxes:

- The executive is proposing legislation to divert all remaining funds, after the \$400,000 distribution to the coal bed methane account, to the general fund. As a consequence, the R&D and the orphan share accounts would again receive no revenues from this source
- Metalliferous mines taxes - seven percent of this funding source is directed to the reclamation and development account.

The executive is proposing the following change that affects the distribution of metalliferous mines tax:

- Legislation proposed by the executive would divert seven percent of the metalliferous mines tax from the R&D to the general fund. As proposed, the diversion would continue until the end of the 2005 biennium

Trust Interest

The third element shows the amount of interest generated by the RIT and the amounts that are allocated by statute for specific purposes in the 2003 biennium. 15-38-202, MCA, directs how interest from the RIT trust will be allocated. Driven by RTIC estimates, \$14.8 million of interest is allocated to a number of sources. The constitution does not restrict the spending of interest from the RIT. For the 2003 biennium, statute allocates \$8.7 million of the interest for eight purposes.

The executive has proposed the following change to the direct interest allocation from the RIT:

- The executive is proposing legislation to reduce the direct interest allocation to the Department of Fish, Wildlife, and Parks for future fisheries projects by \$100,000 each year of the biennium

After the proposed change, Figure 12 shows direct interest allocations from the RIT for the 2005 biennium.

Once the direct allocations are made, seven main accounts that receive RIT interest and other revenues are shown in the fourth element. Any interest remaining is now allocated as follows for appropriation by the legislature in HB 2:

- 25.5 percent to the renewable resource account, which funds programs in the Judiciary, Department of Natural Resources and Conservation, State Library Commission, MSU Northern, and the Governor's Office
- 45.0 percent to the reclamation and development account, which funds programs in the Department of Environmental Quality, Department of Natural Resources and Conservation, and the State Library Commission – This account also receives portions of the RIGWA and the applicable portion of oil and gas tax proceeds
- 22.0 percent to the hazardous waste/CERCLA account, which funds remediation activities in the Department of Environmental Quality
- 7.5 percent to the environmental quality protection fund, which funds remediation activities in the Department of Environmental Quality

Figure 12
Resource Indemnity Trust
Direct Allocation of Interest
2005 Biennium

Purpose	Source of Appropriation Authority	Amount
1 Environmental Contingency Account	Statutory	(\$175,000)
2 Oil & Gas Prod. Damage Mitigation Account	Statutory	(50,000)
3 Water Storage Account	HB 2	(500,000)
4 Groundwater Assessment Account	HB 2	(600,000)
5 MSU-Northern Statutory Appropriation	Statutory	(480,000)
6 Fish, Wildlife, and Parks -- Future Fisheries	HB 5	(500,000)
7 Renewable Resource Grant & Loan Program	HB 6	(4,000,000)
8 Reclamation & Development Grants	HB 7	(2,400,000)
Total Direct Allocation of Interest From RIT		<u>(\$8,705,000)</u>

Fund Balances

Of the seven tracked funds that derive income from the RIT related sources, four are projected to have a negative balance at the end of the 2005 biennium based upon the Executive Budget. At any given point in time, each of these fund balances may be higher than presented. Each of these ending fund balances are calculated to reflect the amount of money expected to be available for legislative appropriation after requested new proposals and present law adjustment are taken into account. These balances are shown in Figure 13.

4

Figure 13

Related Expenditure Accounts (2005 biennium totals)	Renewable Resource (02272)	Reclamation & Development (02458)	Haz Waste CERCLA (02070)	Environmental Quality Protect. (02162)	Groundwater Assessment (02289)****	Water Storage (02216)	Orphan Share (02472)
Further Distribution % of RIT Interest	25.5%	45%	22%	7.5%	0%	0%	0%
Beginning Fiscal 2003 Fund Balance (SABHRS)	\$1,735,291	\$1,892,201	\$316,945	\$522,451	\$252,454	\$1,355,112	\$4,224,786
Continuing Appropriations	(3,021,609)	(4,543,177)	0	(150,000)	0	(511,136)	(2,135,381)
Reserved for Long-Term Assets (Outstanding Loans)	(362,823)					(1,993,831)	
Long-term Liability						836,946	
Fiscal 2003 Appropriations	(1,578,116)	(3,388,647)	(967,846)	(826,407)	(666,000)	0	(26,018)
Fiscal 2003 Legislative Adjustments	0	1,000,000	0	0	0	0	(1,000,000)
Fiscal 2003 revenues (RTIC, Agency Estimates)	<u>3,093,185</u>	<u>3,036,150</u>	<u>732,140</u>	<u>503,525</u>	<u>666,000</u>	<u>641,966</u>	<u>357,000</u>
Projected Available Fund Balance Beginning FY2004	(\$134,072)	(\$2,003,473)	\$81,239	\$49,569	\$252,454	\$329,057	\$1,420,387
Revenues (RTIC, Agency Estimates)							
RIT Interest-direct	\$4,480,000	\$2,400,000			\$600,000	\$500,000	
RIT Interest-further allocation by above %	1,543,770	2,724,300	1,331,880	454,050			
RIGWA Proceeds		0			717,000		
Metal mines tax (7%)		0					
Sweep of Excess Coal Tax & Interest (from 04011)							
STIP/Other Interest			18,000	14,000		34,000	
Cost Recoveries				1,450,000			
Transfers			600,000				(600,000)
Administrative Fees	55,000						
State-owned Project Revenue	-	-	-	-	-	173,000	-
Total Revenues	\$6,078,770	\$5,124,300	\$1,949,880	\$1,918,050	\$1,317,000	\$707,000	(\$600,000)
Executive Appropriations							
House Bills 6 and 7 Grants (Executive Recommended)	\$4,000,000	\$2,400,000					
House Bill 6-Emergency/Private Grants (Recommended)							
MSU-Northern (Statutorily Appropriated)	480,000						
UM-Bureau of Mines					\$1,332,000		
DNRC-Conservation and Resource Devel Division	649,282	1,000,000					
DNRC-Water Resources Division						1,870,000	
DEQ-Central Management		72,527	37,172	1,705			
DEQ-Planning, Prevention & Assistance			\$322,013				
DEQ-Enforcement		9,463					
DEQ-Remediation			424,032	1,903,195			2,664,296
DEQ-Permitting & Compliance		3,058,285	1,054,377				
Governor's Office-Flathead Basin Commission	90,020						
Judiciary-Water Court	1,444,788						
Library Commission-NRIS	0	367,412					
Library Commission-State Library Operations	415,110						
House Bill 13 (executive pay plan estimate)	-	-	-	-	-	-	-
Total Appropriations	\$7,079,200	\$6,907,687	\$1,837,594	\$1,904,900	\$1,332,000	\$1,870,000	\$2,664,296
Projected 2005 Biennium Ending Balance	<u>(\$1,134,502)</u>	<u>(\$3,786,860)</u>	<u>\$193,525</u>	<u>\$62,719</u>	<u>\$237,454</u>	<u>(\$833,943)</u>	<u>(\$1,843,909)</u>

** The Governor must report on the expenditures from the environmental contingency account in the Executive Budget. Expenditures are statutorily appropriated.

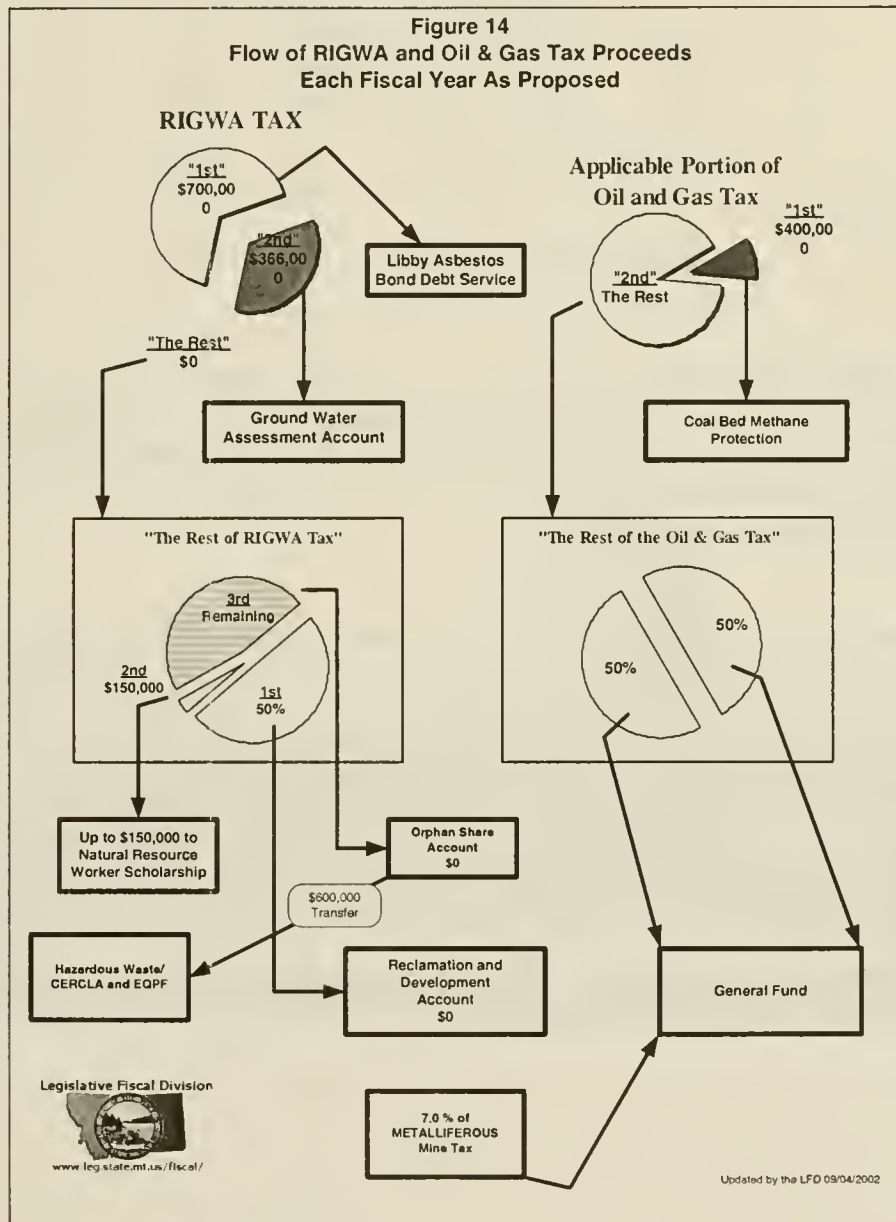
*** Amounts are deposited to the oil & gas production damage mitigation account to bring the balance up to \$200,000 (82-11-161, MCA). All money in the account is statutorily appropriated.

**** Amounts are deposited to the groundwater assessment account to bring the balance up to \$666,000.

The executive has proposed the following change that could affect the ending fund balance of three RIT related funds:

The executive is proposing legislation that would allow the department to transfer up to \$600,000 of funds to the hazardous waste CERCLA and/or the environmental quality protection fund to provide a source of cash to fund appropriations made in HB 2. This proposed change is problematic for two reasons: 1) without a transfer to the hazardous waste CERCLA account, that account is projected to have a negative fund balance of \$406,475 at the end of the 2005 biennium; and 2) the transfer is proposed to come from the orphan share fund. Before a transfer out of that fund, it is projected to have a negative fund balance of \$1.2 million at the end of the 2005 biennium.

Figure 14 shows the impacts of the proposed executive changes:



As a consequence of the executive proposals, the renewable resource, reclamation and development, and orphan share accounts are projected to have significant deficit fund balances. The following figure illustrates the impacts on the RIT fund balances of implementing tax and interest distribution changes. As shown, the "As Proposed" section represents changes for Libby debt service, diversion of the applicable portion of oil and gas tax and metaliferrous mines tax to the general fund, and the proposed decrease in the direct interest allocation to the Department of Fish, Wildlife and Parks for Future Fisheries projects. In contrast, the current law section represents tax and interest distribution levels as they came out of the August 2002 Special Session.

Figure 15
Resource Indemnity Trust
Current Law / Proposed
Ending Fund Balance Difference on 2005 Projection

	Renewable Resource (02272)	Reclamation & Haz. Waste Development CERCLA (02458) (02070)	Environmental Quality Protect. (02162)	Groundwater Assessment (02289)	Water Storage (02216)	Orphan Share (02472)	
As Proposed	(\$1,134,502)	(\$3,786,860)	\$193,525	\$62,719	\$237,454	(\$833,943)	(\$1,843,909)
Current law (2005 projection) (With Revenue Changes)	<u>(1,185,502)</u>	<u>(704,520)</u>	<u>(450,475)</u>	<u>47,719</u>	<u>252,454</u>	<u>(833,943)</u>	<u>1,068,091</u>
Difference	<u>\$51,000</u>	<u>(\$3,082,340)</u>	<u>\$644,000</u>	<u>\$15,000</u>	<u>(\$15,000)</u>	<u>\$0</u>	<u>(\$2,912,000)</u>

LFD ISSUE

The executive proposes spending from accounts that derive interest from the RIT and related funding sources that exceed anticipated revenues. Decreased revenues and increasing appropriations over the last couple of biennia have spread the RIT-related funding sources thin. The legislature may wish to examine the following options when contemplating changes to the fiscal 2005 biennium:

Options:

- Reduce total appropriations – In the four RIT accounts with projected negative ending fund balances, the legislature could reduce agency appropriation levels by a percentage large enough that the projected fund balances will not be negative – Those percentages would be: 1) renewable resources, 16.0 percent; 2) reclamation and development, 54.8 percent; 3) water storage, 44.6 percent; 4) orphan share, 69.2 percent
- Enact statutory changes to add enough additional revenue into each of the identified funding sources to reflect a positive projected ending fund balance
- Approve all decision packages and/or legislation that propose to change how the identified funding sources are utilized

For additional RIT information, please see the agency summary section of the Department of Natural Resources and Conservation in Volume 4, page C-123.

GENERAL REFERENCE

Budget Basics

Agency Budget Comparisons by Fund

Trust Funds





BUDGET BASICS

INTRODUCTION

This section provides an overview of certain basic budgeting and appropriations concepts, terms, and tools. It consists of the following sections.

Budget Process – A Primer. This document provides a basic grounding in a number of budget terms and concepts used in budgeting and appropriations and throughout the Legislative Budget Analysis.

Public School Funding – A Primer. K-12 public school funding is not only a significant general fund expenditure and an area of major legislative policy, the concepts and methodologies used to determine the budget are very complex. This section is designed to provide grounding in the workings of the BASE aid school funding mechanisms. A discussion of the 2005 biennium proposed K-12 expenditures is included in the Office of Public Instruction narrative on page E-14, Volume 4 of the Legislative Budget Analysis.

General Fund Status Sheet. The general fund status sheet is produced by the Legislative Fiscal Division throughout the legislative session (beginning approximately mid-way through) and provides the legislature with a current projection of the financial status of the general fund. This section describes the sheet and explains its components.

Budget Comparison Methodology. The legislature has traditionally compared expenditure growth from biennium to biennium to assess performance and growth patterns. Statute prescribes the methodology used to ensure consistent, accurate comparisons. This section explains the methodology. Figures 1 and 2 on pages 58 and 59 of this volume provide the comparison.

Index to Other LFD Budget Reference Documents. Previous year Legislative Budget Analysis and Legislative Fiscal Reports, current training publications, and brochures on various fiscal topics are available as additional tools available to the legislature and other interested parties. This section describes these resources.

BUDGET PROCESS – A PRIMER

PURPOSE

This section provides an overview of the basic budget concepts, definitions of budget terms, and background and reference information pertinent to the 2005 biennium budget and legislative appropriations process. For more in-depth information, see "Understanding State Finances and the Budgeting Process", available through the Legislative Fiscal Division.

TYPES OF LEGISLATIVE APPROPRIATIONS

Article VIII, Section 14, of the Montana Constitution reads:

“Prohibited Payments: Except for interest on the public debt, no money shall be paid out of the treasury unless upon an appropriation made by law and a warrant drawn by the proper officer in pursuance thereof.”

Appropriations power lies with the legislature. In 17-7-501, MCA, three types of appropriations fall within the meanings of “appropriation made by law” as used in Article VIII, Section 14, of the Montana Constitution.

Temporary appropriations – Most activities of state government are funded on a temporary basis, usually for two-year periods. Funding, therefore, must be reauthorized by each legislature. The main vehicle for the provision of temporary appropriations is HB 2 (the General Appropriations Act).

Statutory appropriations – Statutory appropriations are made directly in statute, and are automatically made until and unless the law is changed. Statutory appropriations are listed in 17-7-502, MCA.

Budget amendments – Various authorities (most often the Governor) can approve the addition of certain funds (primarily federal) during the interim if certain statutorily- defined conditions are met. General fund appropriations cannot be added without express legislative approval.

In limited cases, authorizations to expend funds can also be made through appropriation or under general laws and contracts. The great majority of state agency operations are funded through temporary appropriations.

FUND TYPES

Governmental accounting differs from private enterprise accounting in that funding is segregated and defined by the source and use of the funding. There are four main groups of funds in state government accounting.

1. Governmental funds consist of the following funds:

- General fund includes all financial resources except those that must be accounted for in another fund. The general fund collects most general taxes levied, including individual and corporate income tax, property tax, and investment income. Revenue from a number of other taxes is also deposited into the general fund.
- Special revenue funds consist primarily of two funds. 1) State special revenue is money from state and other sources earmarked for the purpose of defraying particular costs of an agency, program, or function. The largest state special revenue accounts are the Highways State Special Revenue Account (HSSRA), which collects various fuel taxes and is used to support highway-related functions, and the general license account, which collects various hunting and fishing fees and is used to support functions in the Department of Fish, Wildlife, and Parks. 2) Federal special revenue is revenue from federal sources. Most state agencies receive some federal funds. The two major sources of federal funds are used to support highway-related functions and human services programs such as Medicaid. This fund also accounts for trust activity formerly defined as expendable trusts.

- Debt service funds are used to account for the accumulation of resources for the payment of general long-term obligations, including principal and interest. Debt service funds are statutorily appropriated.
 - Capital projects funds are financial resources used for the acquisition or construction of major fixed assets. These funds are appropriated through bills that fund capital projects.
 - Permanent funds account for resources that are restricted to the extent that only earnings and not principal may be expended for purposes that support state programs. These resources were formerly classified as non-expendable trusts (i.e. the coal tax trust).
2. Proprietary funds are used for operations that provide goods or services to the public on a user-charge basis (enterprise funds), or to other agencies or programs of state government (internal service funds).
 3. Fiduciary funds provide for those assets held by state government in a trustee capacity, or as an agency for individuals, private organizations, other governmental entities, or other funds.
 4. University funds are used to support the university system and are classified according to the College and University Business Association (CUBA) structure. The legislature appropriates a portion of the funds used to support the university system as governmental funds, which are then reclassified as university system funds.

With the exception of a small portion of proprietary funds, the legislature does not directly appropriate proprietary, fiduciary, or university funds. The legislature directly appropriates most governmental funds. Debt service funds are usually statutorily appropriated. Capital projects funds are appropriated in the bills that fund the capital projects. The great majority of general fund monies and special revenue funds are appropriated through temporary appropriations bills.

HB 2

The temporary spending bill through which almost 83 percent of general fund monies and special revenue funds are appropriated is HB 2, the General Appropriations Act. The budget analysis contained in Volumes 3 and 4 of the Legislative Fiscal Division 2005 Biennium Executive Budget Analysis concentrates on the appropriations proposed for inclusion in HB 2.

Statute requires that the legislature establish fees and charges for all internal services functions. Statute further restricts programs from increasing those fees and charges during the biennium. The Executive Budget must also include a rate analysis of enterprise funds and internal service fees and charges. While only a small portion of proprietary funds are appropriated in HB 2, all rates approved by the legislature are listed in that bill.

Figure 1 shows all internal services rates reviewed and approved by the legislature.

BUDGET TERMS

Budgets must, by statute, be submitted in three tiers to allow legislative scrutiny of all stages of budget development:

The base - defined as the resources for the operation of state government, and used to cover current biennium expenses of an ongoing and non-extraordinary nature. The base and how it is derived are discussed in more detail in the "Base Budget" portion of this narrative.

Present law - defined as that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature. Present law includes but is not limited to legally-mandated workload, caseload, or enrollment changes, changes in funding requirements, inflationary or deflationary adjustments, and elimination of one-time appropriations.

New proposals - defined as requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

Changes to the budget are made individually through decision packages, which must be approved by the legislature. Decision packages can either change present law or add new proposals approved for funding.

SUBMISSION DATES

The director of the Office of Budget and Program Planning (OBPP) is required to submit a preliminary budget reflecting the base budget to the LFD by October 10, and a preliminary budget reflecting a present law base by November 1 in the year before a session. The director is further required to submit an entire preliminary budget by November 15. The LFD provides a detailed and comprehensive analysis of the Executive Budget, as well as an analysis of other fiscal policy issues.

BASE BUDGET

The current Executive Budget used actual fiscal 2002 expenditures as recorded on the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) as the base for determining a present law budget for the 2005 biennium. Certain items were then excluded in order to create a base that reflects only: 1) the cost of ongoing programs or functions approved by the last legislature; and 2) expenditures authorized by the legislature. OBPP and LFD staff reached agreement on virtually all

Figure 1
Internal Services Functions
2005 Biennium

Agency/Program or Function
Secretary of State
Records Management
Administrative Rules
Transportation
Motor Pool
Equipment
Revenue
Customer Service Center
Administration
Accounting/Management Support
Procurement and Printing
Information Services, including SABHRS Operations
General Services
Mail and Distribution
Professional Development Center
Payroll
State Employee Benefits
Risk Management/Tort Defense
Fish, Wildlife, and Parks
Administration and Finance
Capitol Grounds Maintenance
Aircraft and Vehicle Usage
Duplicating and Bindery
Environmental Quality
Central Management
Natural Resources and Conservation
Air Operations
Commerce
Local Government Services
Board of Investments
Director/Management Services
Justice
Agency Legal Services
Corrections
Corrections Enterprises
Cook/Chill
Labor and Industry
Professional and Occupational Licensing
Central Services Division
Office of Public Instruction
Centralized Services
Advanced Drivers Education
Montana University System

expenditures removed from the base. The LFD analysis provides an explanation within context of any program in which a base difference remains.

Following is an explanation of each type of expenditure category excluded from the base:

Appropriation Transfers

Section 17-7-301, MCA, allows the Governor to authorize the transfer of funds appropriated for the second year of the biennium to the first year, if the Governor finds that “due to an unforeseen or an unanticipated emergency” the amount appropriated for the first year of the biennium “will be insufficient for the operation and maintenance of the department.” Since such transfers do not result from legislative action and may be used for meeting one-time costs, these transfers are excluded from the base. However, if the transfer funds an ongoing cost, OBPP adjusts the present law budgets for the next biennium accordingly.

Budget Amendments

Budget amendments provide temporary authority allowing agencies to spend unanticipated non-general fund revenue received after the legislature has adjourned. This revenue can be used to provide additional services. In accordance with 17-7-402, MCA, budget amendment authority terminates at the end of each biennium and can make no “ascertainable present or future significant commitment for increased general fund support.” Expenditures financed through budget amendments are excluded from the base. If an agency wishes to continue an activity financed with a budget amendment in the following biennium, the request must be presented as a new proposal.

One-Time Appropriations

In general, miscellaneous or “cat and dog” appropriations (appropriations made in bills other than the general appropriations act) are considered “one-time” and not continued in the base. The legislature may specify in appropriation acts that an appropriation is not intended to be ongoing and may not be included in the base.

Language Appropriations

In appropriation acts, the legislature may authorize expenditure of funds from a specific source without providing a specific dollar appropriation. Language appropriations are generally used when an agency knows that it will be receiving federal or state special revenue funds (that it is required by statute to spend) but is uncertain as to the amount of those funds. In order to be sanctioned by law as an appropriation, the language must, at least, fix a maximum amount that the appropriations may not exceed. Assuming that ongoing expenditures from these sources are one-time only in nature, the expenditures are excluded from the base.

Non-Budgeted Expenditures

Generally Accepted Accounting Principles (GAAP) require agencies to make accounting entries for depreciation, amortization, and other financial transactions that appear as expenditures, but don't result in the actual expenditure of funds from the state treasury.

Statutory Appropriations

Section 17-7-501, MCA, provides that funds may be appropriated in permanent law rather than through appropriation bills, which are effective for one biennium only. In order for a statutory appropriation to be valid, the statute creating the appropriation must specifically state that it is a statutory appropriation. The statute must then be listed in section 17-7-502, MCA. Currently, there are 71 valid statutory appropriation references listed. Examples of statutory appropriations include reimbursements to local governments and debt service payments.

Other Appropriations

This category includes administrative transfers created by OBPP, continuing appropriations from previous years, internal offset adjustments to appropriations, and miscellaneous appropriations.

ENTITLEMENT AND FORMULA-FUNDED PROGRAMS

Under current state and federal law, certain programs are "entitlement programs," which means that if an individual meets the underlying criteria for qualification, services must be provided (i.e., the person is "entitled" to the service). Projected growth or declines in these programs are funded as part of the present law budget, rather than through new proposals. For example, the legislature has established statutory levels of state support for each child enrolled in Montana public schools. Similarly, federal and state laws require that persons eligible for Medicaid receive specified services or grants. Programs treated as entitlement include K-12 BASE aid, subsidized adoption, foster care, and Medicaid.

PERSONAL SERVICES "SNAPSHOT"

Personal services costs comprise over 46 percent of total agency operating expenditures (excluding capital outlay, grants and benefits, and transfers) in the 2005 biennium Executive Budget.

The Executive Budget is based on a "snapshot" of actual salaries for authorized FTE, as they existed in the last pay period of fiscal 2002. The Executive Budget includes annualization of the pay increases appropriated in fiscal 2002 and 2003.

Benefits are added on an individual FTE basis. Workers' Compensation and Unemployment Insurance rates vary from agency to agency, as each agency has a different rate based upon experience.

VACANCY SAVINGS

Vacancy savings is the difference between the full appropriated cost and the actual cost of authorized employee positions during a budget period. Since 1979, the legislature has periodically applied a vacancy savings factor to agency budgets in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than the amounts appropriated.

During the 1997 biennium, the legislature included varying vacancy savings rates among selected agencies, and among programs within agencies, in order to fund the executive pay plan. A contingency fund containing \$500,000 general fund and \$1,000,000 in other funds was included for this purpose.

During the 1999 biennium, the legislature applied a uniform 3 percent vacancy savings rate against all positions in state government, with the exception of those positions in agencies with fewer than 20 FTE. The legislature also assumed that any new positions added via new proposals would not be hired at the

very beginning of the fiscal year as a result of the need to recruit and to meet other requirements demanding the expenditure of time. Operating under the assumption that such positions would not be filled for the first three months of the fiscal year, the legislature applied a 25 percent vacancy savings rate in the first year. The legislature also provided \$2.3 million general fund and \$8.8 million in other funds for the biennium in support of a contingency pool for those agencies that could not meet their vacancy savings targets. A further discussion of the pay plan is included in the "Global Executive Budget Proposals" section of this volume.

For the 2001 biennium, the legislature adopted a vacancy savings rate of 3 percent on all personal services except insurance. This rate was not applied to agencies with fewer than 20 FTE, elected officials, university system faculty or to direct care workers within the Department of Corrections. The legislature funded a contingency pool of \$700,000 from the general fund and \$950,000 in other funding for the biennium.

For the 2003 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. As in the 2001 biennium, agencies with fewer than 20 FTE as well as university system faculty were exempt. The legislature also included a contingency fund of \$1.3 million general fund and \$3.0 million from other funds (the legislative branch also received \$200,000 general fund) for the biennium to meet potential costs involved for those agencies that do not meet their vacancy savings targets.

For the 2005 biennium, the Executive Budget proposes a 4 percent vacancy savings rate on all personal services. As in the 2003 biennium, agencies with fewer than 20 FTE as well as university system faculty are exempt. Unlike prior years, the Executive Budget does not contain a contingency fund to meet potential costs in excess of the appropriation.

FIXED COSTS

Agencies are charged fees (called fixed costs) for a variety of services provided by other state agencies. The Executive Budget includes fixed costs for the following services: Department of Administration (DofA) insurance and bonds (62104), DofA warrant writing fees (62113), DofA payroll service fees (62114), Legislative Auditor audit fees (62122), SABHRS (Statewide Accounting, Budgeting, and Human Resources System) operating costs (62148), DofA network fees (62174), messenger services (62307), State Motor Pool leases (62510), DofA rent (62527), capitol complex grounds maintenance (62770), MTPRRIME (Montana Project to Reengineer the Revenue and Information Management Environment, the precursor to SABHRS) debt service costs (62875), and the state fund cost allocation plan (62895).

Figure 2 shows the total amounts included in the Executive Budget for fixed costs.

Insurance and Bonds

The Risk Management and Tort Defense Division of the DofA collects premiums from state agencies for: 1) administration of the self-insurance program, which provides state agencies with general liability and automobile coverage; and 2) purchase of commercial policies for state agency property, aircraft, and to protect against the potential consequences of other risks. Costs are allocated to agencies based upon actual loss experience and inherent exposure.

Figure 2 Fixed Costs 2005 Biennium Executive Budget (in millions)		
Subcommittee/Agency	Function	Total
General Government		
Administration	Insurance and Bonds	\$ 30.223
	Warrant Writing Fees	1.733
	Payroll Service Fees	0.897
	Data Network Services	19.455
	SABHRS Operating	9.446
	Messenger Services	0.268
	Rent - Buildings	11.506
Legislative Audit Division	Audit Fees	2.799
Natural Resources and Commerce		
Fish, Wildlife, and Parks	Grounds Maintenance	0.653
Various	State Fund Allocation Plan/MTTPRIME Bonds	2.209
Total		<u>\$ 79.188</u>

Warrant Writing Fees

DofA provides warrant writing and direct deposit services for agency financial transactions. The costs of these services are allocated to agencies based upon actual utilization of the various types of transactions in the three previous years.

Payroll Service Fees

The State Payroll Program in DofA prepares and distributes payroll for all state agencies. Costs of these services are allocated to agencies based upon the number of paychecks issued for each agency per year.

Audit Fees

The legislative Audit Division charges agencies for the costs of financial compliance audits. These charges are included in agency budgets as biennial appropriations and allocated according to the estimated number of billable hours for each agency audit.

SABHRS Operations Unit

This unit provides all operational support for the Statewide Accounting, Budget, and Human Resources System (SABHRS). Costs were allocated in the Executive Budget based upon the number of full-time equivalent employees.

Data Network Services

The Information Services Division (ISD) of DofA charges agencies for the technology network that allows agency personal computers to be attached to the state mainframe and, via the mainframe, to other agency computers. Costs for this service are allocated to agencies based upon the projected number of personal computers connected to the network each year. A fixed monthly rate per computer is used to determine the overall agency charge.

Messenger Service

The Mail and Distribution Program in DofA charges state agencies for interagency mail pickup and delivery services. Costs for these services are allocated to agencies based upon the volume of mail generated by, and number of daily deliveries to, each agency.

Rent

The General Services Division (GSD) of DofA charges rent to state agencies for costs relative to maintaining office and warehouse space in the capitol complex buildings managed by GSD. Included in the charges are utility, security and janitorial services, mechanical maintenance, and minor maintenance costs including such items as painting, lighting and carpeting. Warehouse costs are allocated to agencies based upon the amount of square footage of office warehouse space occupied; a fixed rate per square foot is used.

Grounds Maintenance

The Parks Division of FWP charges state agencies for grounds maintenance and snow removal at capitol complex buildings. Costs of these services are allocated based upon the square footage of office space occupied by a given agency.

MTPRRIME Bond Costs

MTPRRIME was funded using general obligation bonds. The costs of repaying those bonds are allocated to agencies as a fixed cost in the 2005 biennium. Costs were allocated based on the same method used for the SABHRS Operations Unit.

State Fund Cost Allocation Plan (SFCAP)

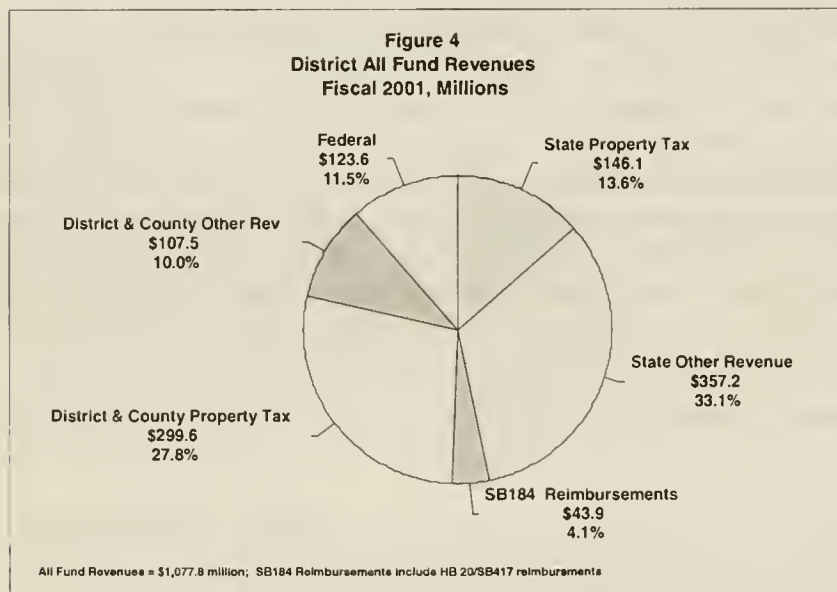
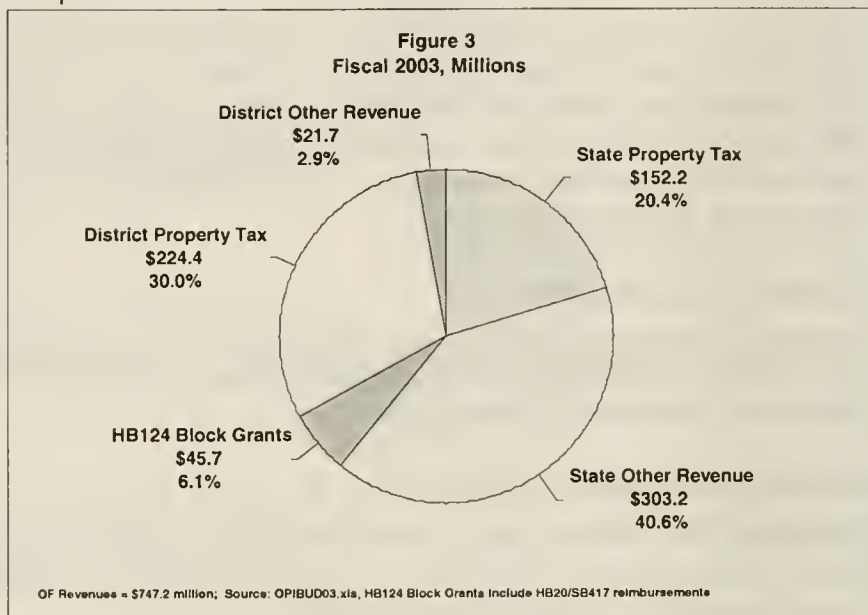
DofA administers the SFCAP, which charges non-general fund agencies and/or programs for those state government operating costs that cannot easily be identified with particular funding sources. Collections are deposited to the general fund to offset a portion of those costs. Operating costs of the following programs are partially recovered through SFCAP collections: State Personnel and the Accounting and Management Support Divisions of DofA, and the Office of Budget and Program Planning in the Governor's Office. Costs are allocated to agencies based upon the following: a) State Personnel - the number of FTE authorized and classified, and the number of negotiated labor contracts held; b) Accounting and Management Support - the number of SABHRS and cash transactions and actual expenditures made; and c) OBPP - the number of FTE employed and budgeted fund expenditures made.

PUBLIC SCHOOL FUNDING – A PRIMER

The purpose of this section is to explain how K-12 education is funded. This section focuses on the major district and county funds for which the state supplies at least some of the funding.

The state share of district general fund revenue has declined over the years. In fiscal 1991, the state's share of district general fund revenue was 71.0 percent. As shown in Figure 3, the state's share of general fund revenue has fallen to 61.0 percent in fiscal 2003.

The state's share includes property tax (the 95 mills) and other state tax revenues. The local share includes property taxes levied for schools by the district or the county, as well as other district and county revenue. HB 124 block grants, which include reimbursements associated with HB 20 and SB417, are state payments to districts and county education accounts to reimburse these funds for revenues that now flow to the state.



As shown in Figure 4, the state's share of revenue in all district funds was 46.7 percent in fiscal 2001.

School districts typically may spend out of ten budgeted funds, and many schools spend out of smaller non-budgeted funds. Any fund that is funded by property tax must be budgeted.

The budgeted funds include: 1) general fund; 2) retirement fund; 3) transportation fund; 4) debt service fund; 5) bus reserve fund; 6) adult education fund; 7) tuition fund; 8)

building reserve fund; 9) flexibility fund; and 10) technology acquisitions. This primer will focus on the first four of these, since state support in these funds is significant.

DISTRICT GENERAL FUND

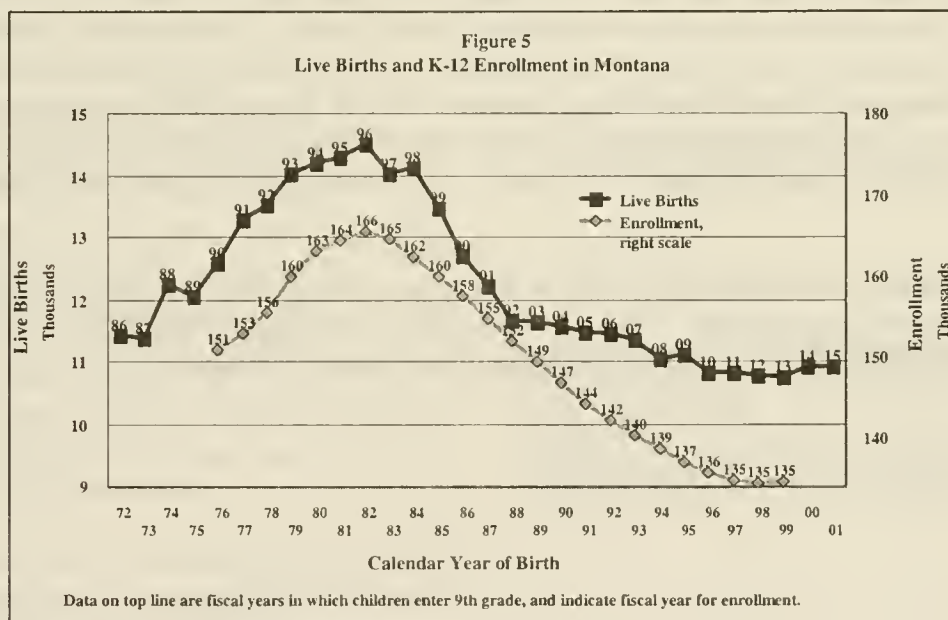
The current system of school finance was established in HB 667, passed by the 1993 legislature and first applied to school funding in fiscal 1994. HB 667 created a system of funding schools in which the state mandates the limits within which a school district may budget its general fund expenditures. The maximum budget is the sum of the district's basic per-district entitlement, its per-ANB entitlement, and 175.0 percent of its special education allowable costs. The BASE (or minimum) budget for a district is the sum of 80.0 percent of the district's basic per-district entitlement, 80.0 percent of its per-ANB entitlement, and up to 140.0 percent of its special education allowable costs.

HB 667 allowed schools that had been budgeting above the newly created maximum budget in the past to continue budgeting at that level indefinitely. Subsequently, this grandfather clause was altered in HB 22 (1993 special session), which required district voters to approve any budget authority above the maximum budget.

In fiscal 1994 when the new system was first implemented, many schools had general fund budgets that were below the BASE budget. Districts with budgets below the BASE budget were required to incrementally increase budget authority and budget at the BASE level by fiscal 1998.

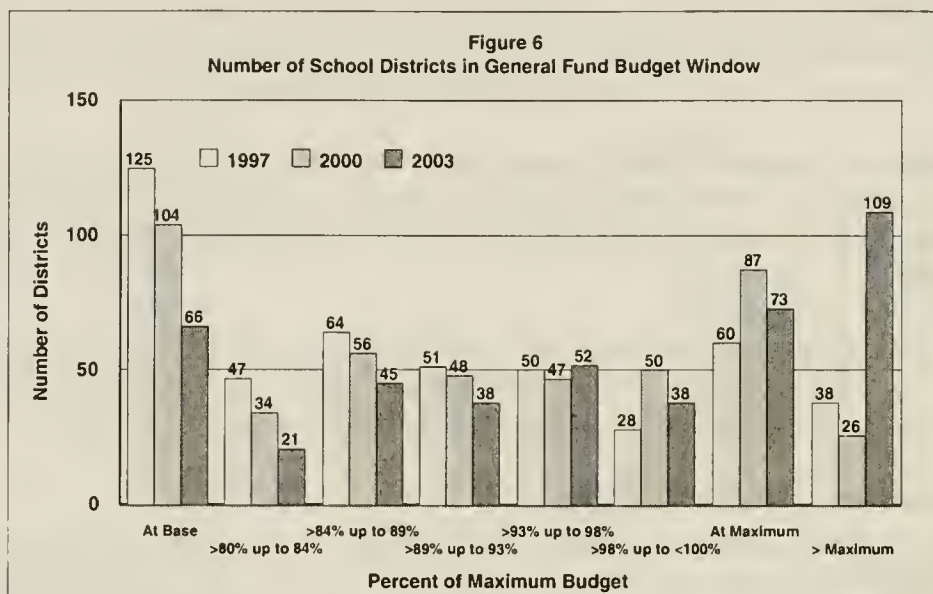
ANB and Maximum and BASE Budgets

The maximum and BASE budgets are related by a formula in statute to Average Number Belonging (ANB), which is enrollment in the prior year adjusted by teacher days. As shown in Figure 5, enrollment peaked in fiscal 1996 and has been declining since, mainly as a result of falling birth rates in the mid 1980's through the late 1990's. Recently births have increased, and it is expected that enrollment declines are expected to cease sometime in the next decade.



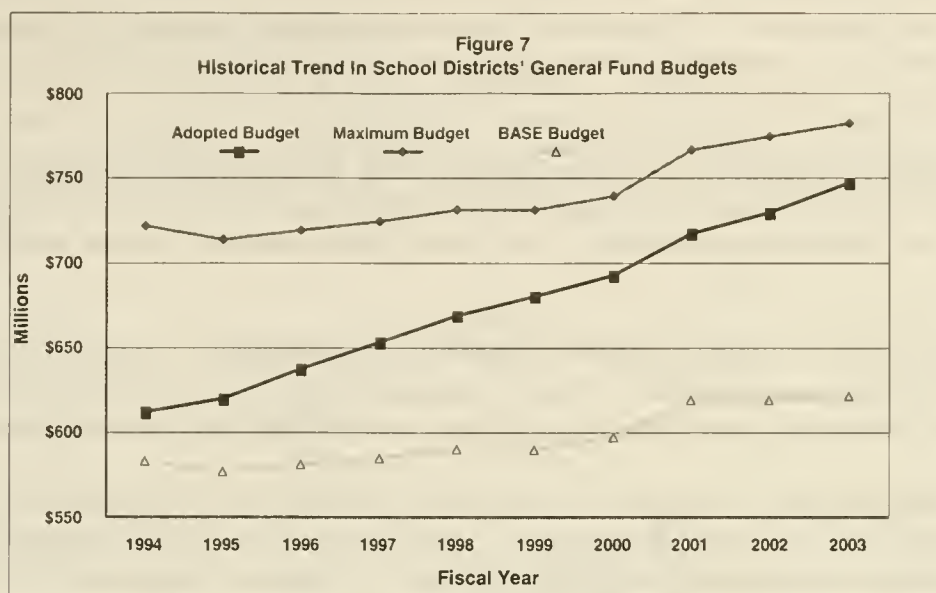
Without legislated changes in the maximum budget, the maximum budget in most school districts will continue to fall, resulting in more districts with maximum budgets.

Figure 6 shows the distribution of districts in the general fund budget window in fiscal 1997, 2000, and 2003 for all districts. The adopted general fund budget for each district is divided by the maximum budget for each year. The number of districts in each of the brackets is then counted. A large number of districts budget at the BASE level although the number has declined. Many of these are schools that were required to increase spending to the BASE budget between fiscal 1994 and 1998.



A large and growing number of districts are budgeting above 98.0 percent of the maximum budget. The number of districts budgeting in this area was 123 (27.0 percent of all districts) in fiscal 1997, 163 districts (36.0 percent) in fiscal 2000, and 220 districts (50.0 percent) in fiscal 2003. More schools are budgeting near the maximum because of declines in ANB, which in the absence of legislation, require lower maximum budgets. Beginning in fiscal 2002 and continuing in fiscal 2003, there are substantially more districts budgeting above the maximum budget. This is due to SB390, passed during the 2001 legislative session, which allowed districts to budget above the maximum budget for 5 years with voter approval. These are called "soft caps". All districts must budget at the maximum budget beginning in fiscal 2007.

As shown in Figure 7, the average general fund budget as a percent of the average maximum budget in fiscal 1994 was about 84.0 percent. This has risen to 95.0 percent in fiscal 2003, primarily as a result of reduced ANB slightly more than offset by legislated entitlement increases.

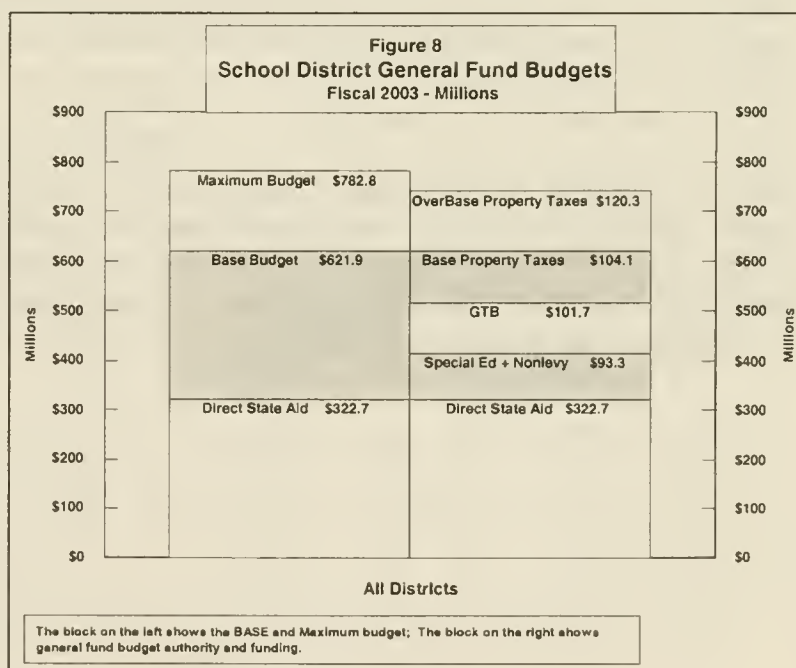


Between fiscal 1997, when ANB was at its peak, and fiscal 2003, ANB fell 8.0 percent. During the period, elementary ANB fell 11.4 percent and high school ANB fell 0.4 percent. In fiscal 2003 there were 13,237 fewer ANB served than in fiscal 1997. During the same period, basic entitlements were increased by the legislature 11.9 percent for both elementary and high school districts. Elementary per-ANB entitlements were increased 16.8 percent and high school per-ANB entitlements were increased by 11.2 percent. Between fiscal 1997 and fiscal 2003, the most severe declines in ANB occurred in the elementary grades. The most severe declines in the future will be in the middle school and high school grades.

Funding the General Fund Budget

As shown in Figure 8, districts' general fund budgets are funded by state and local funds. State funds consist of direct state aid, state guaranteed tax base (GTB), and state special education grants. The sources of local funding are nonlevy revenue (oil, natural gas, and coal receipts, investment interest, and HB 124 block grants), property taxes, and reappropriated fund balances.

Direct state aid is a grant from the state to the district. In fiscal 2003, direct state aid was 44.7 percent of total entitlements used to calculate the maximum budget. The direct state aid percent was 40.0 percent until fiscal 2000 when it was raised to



41.1 percent. The current level of 44.7 percent was instituted during the May 2000 special session for fiscal 2001. Direct state aid is the first source of revenue considered by a district. Because it is directly related to entitlements, the geographic distribution of direct state aid is directly related to where children live.

The portion of the budget above that funded by direct state aid and below the BASE budget is called the GTB budget. This is funded by a combination of special education revenue from the state, nonlevy revenue, and fund balance reappropriated. The total of these revenue sources was \$93.3 million in fiscal 2003.

Special education revenue (\$30.9 million in fiscal 2003) reimburses districts for allowable costs associated with special needs children. Nonlevy revenues (\$49.1 million in fiscal 2003) are revenues from taxes on oil, natural gas, and coal, and investment earnings and HB 124 block grants.

Beginning in fiscal 2002, HB 124 block grants are payments made by the state to districts to reimburse districts for revenue that now flows to the state. These revenues were motor vehicle taxes, taxes on financial institutions, and reimbursements from the state for legislated reductions in districts' business equipment property tax base in prior sessions. While HB 124 block grants are state appropriations to schools, they do not represent an infusion of new state money into district budgets, but rather replace money that used to be considered local revenue.

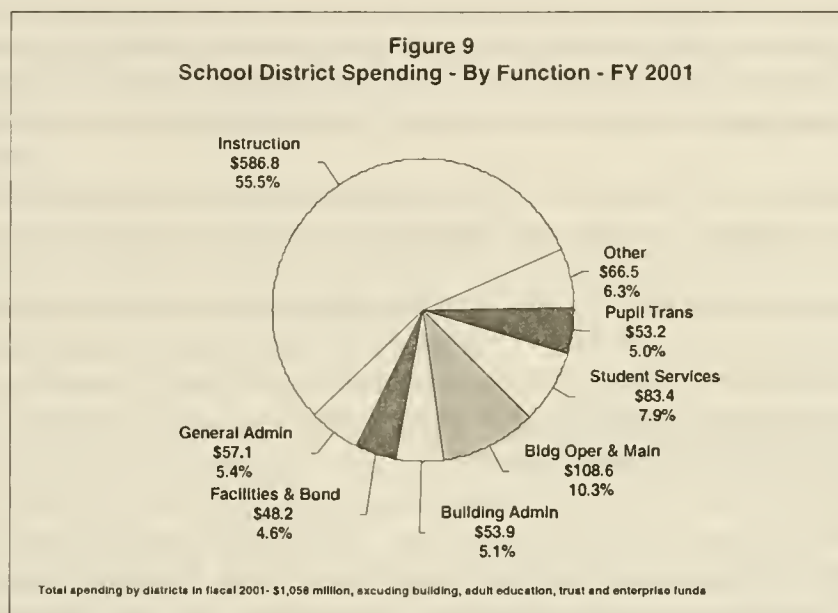
Reappropriated fund balances are unreserved general fund balances left over from the previous year (approximately \$13.3 million in fiscal 2003). Schools may hold in reserve at most an amount equal to 10.0 percent of the general fund budget, and must reappropriate the rest in the ensuing year.

The remaining portion of the GTB area is funded by BASE property taxes (\$104.1 million in fiscal 2003) and state GTB aid (\$101.7 million in fiscal 2003). The amount of GTB aid a district receives depends on its relative wealth, as measured by taxable value per dollar of direct state aid. A relatively poor district's BASE mill levy generates local property taxes and a certain amount of GTB aid. The poorer the district, the more a BASE mill will be worth in terms of GTB aid. Statewide, the average ratio of GTB aid to BASE property tax revenue is a little greater than one. This may vary from zero for wealthy districts to over ten for poor districts.

Districts that budget above the BASE level must do so out of own-source revenue and tuition from other districts, parents, or the state. Some districts are able to use nonlevy revenue to fund a portion of this budget area, but the vast majority levy overBASE mills against property. OverBASE property taxes are \$120.3 million in fiscal 2003, and are a growing source of revenue funding district general fund budgets. OverBase property taxes were only \$34.8 million in fiscal 1994.

General Fund Spending by Function

Figure 9 shows spending by school districts by function. Instruction consumes approximately 56 percent of all spending by districts. Administration accounts for another 10.4 percent. The remaining functions include transportation, student services, spending on facilities and other expenses. These data do not include spending from the adult education fund, the building fund, trust funds, and enterprise funds.



A Short History of Legislative Changes in K-12 Funding

Figure 10 shows the impact of legislation on BASE aid entitlements since fiscal 1994

Figure 10
School District Entitlements - FY 1997 - 2003

Component	FY1994 Actual	FY95-97 Actual	FY1998 Actual	FY1999 Actual	FY2000 Actual	FY2001 Actual	FY2002 Actual	FY2003 Actual
Bill Authorizing Entitlement Change	HB667	HB22	HB47	HB47	SB100	HB4	HB121	HB121
Basic (Per District) Entitlements								
Elementary	\$18,000	\$17,190	\$18,000	\$18,000	\$18,000	\$18,540	\$18,889	\$19,244
Percent Change		-4.5%	4.7%	0.0%	0.0%	3.0%	1.9%	1.9%
High School	\$200,000	\$191,000	\$200,000	\$200,000	\$200,000	\$206,000	\$209,873	\$213,819
Percent Change		-4.5%	4.7%	0.0%	0.0%	3.0%	1.9%	1.9%
Per ANB Entitlements								
Elementary	\$3,500	\$3,343	\$3,376	\$3,410	\$3,529	\$3,763	\$3,834	\$3,906
Percent Change		-4.5%	1.0%	1.0%	3.5%	6.6%	1.9%	1.9%
High School	\$4,900	\$4,680	\$4,726	\$4,773	\$4,821	\$5,015	\$5,109	\$5,205
Percent Change		-4.5%	1.0%	1.0%	1.0%	4.0%	1.9%	1.9%
Base Budget Components								
Direct State Aid	40.0%	40.0%	40.0%	40.0%	41.1%	44.7%	44.7%	44.7%
Guaranteed tax base aid	40.0%	40.0%	40.0%	40.0%	38.9%	35.3%	35.3%	35.3%

The level of entitlements under HB667 was in operation for fiscal 1994 only. The legislature then passed HB22 during the special session of 1993 and cut entitlements by 4.5 percent for fiscal 1995 through fiscal 1997. On average statewide, ANB was increasing in these years.

HB47 was passed by the 1997 legislature and raised per-ANB entitlements beginning in fiscal 1998 by 1 percent per year, and the basic entitlement in fiscal 1998 by 4.7 percent.

SB 100 was passed by the 1999 legislature and increased per-ANB entitlements by 1 percent for high schools and by 3.5 percent for elementary schools in each year of the 2001 biennium. The direct state aid percent was raised from 40.0 percent to 41.1 percent in fiscal 2000 and to 41.8 percent in fiscal 2001. SB 100 also increased special education funding by approximately \$1.5 million per year.

Then in special session in May 2000, HB 4 further raised the per-ANB entitlements in fiscal 2001 by 3.0 percent for both elementary and high school, and raised the direct state aid percent to 44.7 percent.

During the 2001 legislative session, HB 121 raised entitlements by 1.88 percent in fiscal 2002 and by an additional 1.88 percent in fiscal 2003. In addition, SB 390 created a new flexibility account from which districts could spend for nearly the same purposes as the district general fund. The legislature funded the district flexibility accounts with \$5.0 million in state general fund dollars. This was reduced to \$4.3 million in the August 2002 special session.

Special Education

The state will pay approximately \$34.9 million in fiscal 2003 in special education grants and reimbursements to districts and special education cooperatives. Special education cooperatives are groups of districts offering special education services. Districts receive about 90.0 percent of this money in their general funds and spend it for services to children with various disabilities or impairments. The remainder flows to special education cooperatives that provide special education services to its members. The disabilities range from speech-language impairments and physical impairments to multiple disabilities.

In fiscal 2001, districts and coops spent \$78.3 million in state and local contributions and \$14.5 million in federal contributions on the allowable costs associated with the education of impaired students. Allowable costs are defined by the state, which provides grants for special education instruction and related services. State reimbursements are made to schools with extraordinary special education costs. As costs have risen, the amount of reimbursements has also risen, and the amounts of instructional block grants and related services grants have fallen.

The state special education grants and reimbursements flow to district general funds and are incorporated in calculating a district's maximum and BASE general fund budget limits. For each dollar increase in district receipts of state special education dollars, the maximum budget of the district increases by \$1.75 and the BASE budget increases by \$1.40. Increases in special education receipts by districts also increase the state GTB aid paid to a district, since GTB aid depends on the level of the BASE budget.

Special education students were about 12.0 percent of the student population in fiscal 2001. Enrollments of special education students grew by close to 2 percent per year between fiscal years 1991 and 1994, but growth in special education enrollments has grown slowly since then. A new state funding system was put in place in fiscal 1994 that granted districts state special education dollars based on the number of ANB in the entire district. The old system had granted such dollars based on the number of identified special education students in each district.

The amount the state appropriates in special education grants to districts and cooperatives remained between \$32.0 and \$33.0 million between fiscal 1989 and 1999, but has risen to \$34.9 million in fiscal 2003. Districts and coops spent \$40.3 million in fiscal 1990 for special education programs and \$78.3 million in fiscal 2001, an annual growth rate of 7.7 percent per year. The state share of these costs has fallen commensurately.

Districts spend more on special education students than regular students. Spending for special education students was 177.0 percent of spending for regular students in fiscal 1998, and that percentage was up from 157.0 percent in fiscal 1993.

Voting Rules

Many of the decisions regarding the level and funding of general fund budgets must by law be referred to district voters. Beginning in fiscal 2001, the general fund voting provisions for districts adopting a general fund budget between the BASE and the maximum budget limits were amended to require voter approval for an increase in overBASE property tax revenue. Previous law had required a vote in order to increase ensuing year budgets above current year budgets regardless of the property tax revenue consequences. Under the new law, if an increase in budget authority can be funded without increasing overBASE property taxes revenue, the budget increase does not require voter approval. A 4 percent limitation on annual budget growth, or on annual budget growth per ANB, was in effect until July 1, 2001. HB 164, passed during the 2001 legislative session eliminated the growth cap, and districts may now increase their general fund budget by any amount up to the maximum with voter approval.

The 1999 legislature also changed the budgeting rules for districts with declining enrollments. General fund budget limitations were amended for districts that are: 1) budgeting between the BASE and maximum budgets; and 2) have declining ANB populations. If ANB declines less than 30.0 percent and the district's current year adopted budget exceeds the district's ensuing year maximum budget, the district may adopt a budget for the ensuing year that is the greater of the current year budget or the ensuing year's budget, subject to voter approval. The district may not exceed its maximum budget limit for more than five consecutive years.

If ANB declines by 30.0 percent or more and the district's current year adopted budget exceeds the ensuing year's maximum budget, the district must reduce the range between the district's current year budget and the ensuing year's maximum budget by:

- 20.0 percent in the first year
- 25.0 percent in the second year
- 33.3 percent in the third year
- 50.0 percent in the fourth year
- the remainder of the range in the fifth year

Districts that have general fund budgets exceeding the maximum budget must annually ask voters to approve the part of the budget in excess of the maximum. However, the budget adopted for the current year may not exceed the lesser of: 1) the adopted budget for the prior year; or 2) the district current maximum budget plus the over-maximum budget amount adopted for the prior year. If a district's budget in the current year is below the BASE budget in the upcoming year, either due to ANB increases or legislated increases in entitlements, district trustees must increase the budget to the BASE budget level and no voter approval is required.

Effective in fiscal 2000, the regular school and trustee election date is changed to the first Tuesday after the first Monday in May. Only one levy election may be held in a calendar quarter.

DISTRICT TRANSPORTATION BUDGET

Montana law provides for two types of public school transportation - a publicly funded school bus program and/or individual transportation contracts with a student's parents or guardian. School bus transportation may be provided directly by the school district, or the trustees of a district may contract with a private contractor to provide bus transportation for eligible students.

The trustees of a district may provide school bus transportation to any pupil of a public or private school. However, the district will receive reimbursement from the state and county only for eligible transportees. An eligible transportee must:

- Be a resident of the State of Montana and attend a public school in Montana
- Be between the ages of 5 and 21 or be a preschool child with disabilities between the ages of 3 and 6
- Reside at least 3 miles from the nearest operating public elementary school or high school
- Be considered to reside with his or her parent or guardian, who maintains legal residence within the boundaries of the district furnishing the transportation, regardless of where the eligible transportee lives when attending school

The trustees of a district are not required by law to provide pupil transportation unless directed to do so by the county transportation committee. However, if the trustees decide to furnish transportation for any eligible transportee, they must ensure transportation for all eligible transportees.

On-Schedule Costs

A district's transportation budget is funded by receipt of state reimbursements for on-schedule costs, an amount which is matched by the county, and by district revenues, which fund "over-schedule" costs.

On-schedule costs are defined by the legislature and are expressed on a per mile basis. The per mile schedule costs depend on the size of the bus and are adjusted depending on the extent that the bus is filled with riders. On-schedule costs are determined as the product of the per mile amount times miles traveled (including miles within the 3 mile zone) times 180 days. The state general fund reimbursement is one-half this amount or one-half the amount a district budgets for transportation, whichever is less. The county must match the state reimbursement amount with funds derived from the county school transportation fund. County revenues in the county transportation fund include nonlevy revenue and property tax revenues.

District over-schedule costs are the difference between the transportation fund budgeted amount and state and county on-schedule reimbursements. Some districts are able to provide transportation services for the on-schedule amount, but the vast majority of districts incur costs above the on-schedule amount. On-schedule costs vary between 85 cents per mile per day and \$1.80 per mile per day. Larger districts generally have higher per mile costs than small districts. Small districts have generally higher costs per ANB, and per ANB per mile, than do large districts. Districts fund the over-schedule amount through a combination of nonlevy revenues and district property taxes. District trustees may budget the over-schedule amount at their discretion and are not required to ask voters to approve that level. For on-schedule costs, the county superintendent determines the required property tax requirements, and the county commissioners set the required levy.

In fiscal 2001, total district spending was \$43.9 million. On schedule costs were \$21.0 million of which half was paid by the county and half by the state.

Some districts budget for transportation but do not engage in providing transportation. These districts do not own buses and do not contract with a private bus company. In many cases, these districts coordinate their transportation needs with a nearby district. For instance, many elementary districts coordinate with their high school district, if the high school is in the same community.

Approximately one-third of the bus routes in Montana are contracted with private bus companies. These contracts are usually observed in the larger districts. Some small districts, however, also contract and may contract with many private individuals to provide bus service. Contracts in the larger districts are often multi-year, and some provide inflation adjustments and/or gas price adjustments. The contracts are usually on a per mile basis or on a yearly basis for a set number of miles per day. The bus company usually must provide specially equipped buses and bus aides if necessary.

School districts may also contract with parents or guardians of pupils in need of transportation. Under section 20-10-142, MCA, the state and county must reimburse a district that makes a contract with a parent or guardian for transportation of eligible transportees at a rate of 21.25 cents per mile per day. The district may contract with a parent at a higher rate, and in fact federal rules regarding transportation of special needs students require that parents be reimbursed by the district at 29 cents per mile. Allowable miles are determined by multiplying the distance between the eligible transportee's residence and school, minus 6 miles. The total reimbursement is limited to one round trip per day. Districts with parents who transport their children to the nearest bus stop on an approved route are also reimbursed 25 cents per mile per day, with 3 miles deducted from the distance between the home and the bus stop.

RETIREMENT FUND

School districts employing personnel who are members of the teachers retirement system or other defined retirement systems must establish retirement funds from which to pay the districts' contributions to the systems. The amount each district must pay into the retirement fund is set by statute and is a set percentage of the employee's annual wage. Thus the spending requirements in the retirement fund increase with increases in wages and in the number of employees. Also, because teacher wages are paid from the district general fund, the level of spending in the retirement fund is closely related to the level of spending in the general fund. Retirement costs associated with salaries in other state and federal funds are also paid for out of the district retirement fund.

The retirement fund is managed at the county level. The county collects the money and deposits it in district retirement accounts. The district then pays for the retirement contributions. The county retirement fund is funded by nonlevy revenue, state GTB, and local property taxes. A county is eligible for GTB if its taxable value per ANB is less than 121.0 percent of the state average taxable value per ANB. The amount of state GTB varies inversely with the value of a county's taxable property per ANB. Thus, less wealthy counties receive more GTB aid than do relatively more wealthy counties. The retirement fund has been a nonvoted fund. That is, the county superintendent determines the amount of the levy, and the county commissioners fix and set the levy without putting the issue before the voters.

The total payment to districts by counties in fiscal 2001 was \$91.3 million. The state GTB payment to counties for retirement purposes was \$21.1 million in fiscal 2001.

DEBT SERVICE FUND

School districts utilize a debt service fund to make debt service payments on bonds that have been sold to investors. The sale of bonds may be for purposes of capital construction, purchase of certain equipment or vehicles, refinancing past bond issues, or for funding a judgement against a district. Under current law, the state provides capital outlay reimbursements to schools with debt service payments associated with bonds that were sold after July 1, 1991.

Under a formula in statute, a school district's facility reimbursement is a set dollar amount per ANB in the district, which varies depending whether the student is in grades 1-6, 7-8 or in high school. In order for a school to receive a capital outlay reimbursement from the state, it must be GTB-eligible. Its taxable value per ANB must be below 121.0 percent of the state average taxable value per ANB. If a district is GTB-eligible, its school facility reimbursement is the lesser of its actual debt service expenditures or the calculated reimbursement. When the total statewide available reimbursements required exceed the amount available in the state appropriation, the reimbursements are prorated to the eligible districts.

The number of districts receiving school facility payments has grown from 14 districts in fiscal 1994 to 79 districts in fiscal 2002. The state appropriation has grown from \$1.0 million in fiscal 1994 to \$4.4 million in fiscal 2003. In the 1990's, the growth in demand by districts for school facility payments has outstripped the growth in the level of the state appropriation. In fiscal 1994, the pro-rata percentage was 90.0 percent and in fiscal 1998 it was 79.0 percent. However, beginning in fiscal 2000, the pro-rata percent was 100 percent. This declined in fiscal 2001 to 97.7 percent and then was 100.0 percent again in fiscal 2002.

The legislature passed SB 457 during the 2001 legislative session which allowed districts to use up to 25.0 percent of their federal impact aid revenues for debt service. Federal impact aid revenues flow mostly to districts on Indian reservations. The bill may increase debt service spending by districts.

GENERAL FUND STATUS SHEET

The general fund status sheet (GFSS) is analogous to your personal checkbook register. Your bank balance fluctuates either up or down as you make deposits and expend monies. Similarly, the GFSS simply measures the state's financial condition as the legislature adjusts revenue flows (taxation policies) and appropriates funds (authorizes expenditures).

The GFSS is prepared during legislative sessions in order to provide the legislature with a current projection of the financial status of the general fund account. This budgetary status sheet is usually prepared at least once a week and serves as a "work in progress" tool to assist the legislature in balancing the state's general fund budget. Financial information on revenue estimates, taxation legislation, and appropriation measures are the basic components of the GFSS. The status sheet is usually prepared on Fridays and distributed either late Friday night or early Saturday morning.

The starting point for the status sheet is the projected general fund balance *before* any legislative action has been taken. This balance is based on revenue estimates adopted by the Revenue and Transportation Interim Committee (RTIC) on November 19, 2002, agency base budgets for fiscal 2002 as assumed for fiscal 2004 and 2005, LFD estimates for all statutory appropriations, fund balance adjustments, residual equity transfers, and the Executive Budget recommendations for supplemental appropriations.

The status sheet also shows any proposed legislation that has general fund fiscal impact (revenue or disbursement). These bills are posted to the document after any committee takes positive executive action. Subsequent amendments to bills are also incorporated into the document once they have been adopted by a committee. The projected ending balance *after* legislative action to date is provided to show the legislature a "point in time" status of the general fund account.

The status sheet also includes all general fund bills that could change the level of spending for state agencies. These bills, categorized as "potential appropriations," result from legislation that changes the duties and functions of state agencies without making a corresponding appropriation adjustment. These adjustments are considered by the House Bill 2 Conference Committee toward the end of the legislative session. These "potential" spending changes are *not* included in the projected ending balance until *after* legislative action has been taken.

Attached to the status sheet is a summary of budget development by joint appropriation subcommittees. These summaries show the budgets as approved by the subcommittees, as compared to the base budget for fiscal 2002. Both general fund and all funds detail are provided.

The information shown on the next page is an example of what the first GFSS will look like.

LFD staff are available to assist legislators in interpreting the general fund status sheet.

Legislative Fiscal Division General Fund Status Sheet

2003 Biennium (Figures In Millions)

12/20/2002

03:05 PM

90 th Legislative Day

Status #13

Fiscal Condition Without Legislative Action

Beginning Fund Balance(Without Feed Bill & Supplementals)	\$130.793 +
Revenue & Taxation Committee Revenue Estimates	2,400.465 +
Base Appropriations Using Fiscal 2000	(2,090.916) -
Estimated Reversions & 2003 Session Cost	(1.001) -
Estimated Statutory Appropriations	(96.730) -
Estimated Transfers	(9.700) -
Estimated Adjustments & Residual Transfers	0.000 +
Ending Fund Balance Without Legislative Action	= \$332.911

Summary of Legislative Action

Revenue Adjustments

HJR 2 Revenue Estimates			+	29.765
House Taxation	FY 2001=\$5 624FY 2002-2003=\$6 991	12 614		
House Floor	No Change	0 000		
Senate Taxation	FY 2001=\$9 231FY 2002-2003=\$2.24	11 477		
Senate Taxation	Fund Balance Adjustment for FY 2000	5 674		
Senate Floor	No Change	0 000		
Conference	Not Required	0 000		
Revenue Legislation (See Table 1 For Detailed Bill Listing)			+	356.396

Appropriation Adjustments

HB0002 General Appropriations Act	Present Law	New Proposal	-	(227.928)
General Government & Transportation	(86 477)	103 276		
Health & Human Services	(50 537)	(27 897)		
Natural Resources & Commerce	(2 917)	(73 328)		
Corrections & Public Safety	(22 912)	0 874		
Education	(28 245)	(29 765)		
Totals	(\$191.088)	(\$36 840)		

Other Appropriation Legislation (See Table 1 For Detailed Bill Listing) - (437.320)

Total Legislative Action - (\$279.087)

Fiscal Condition With Legislative Action \$332.911 - (\$279.087) = \$53.824

Legislative Fiscal Division General Fund Status Sheet

2005 Biennium (Figures In Millions)

01/03/2003 10:15 AM

1st Legislative Day

Status #1

Table 1 - Detail of Legislative Action

Bill Number	Short Description of Proposed Legislation	Revenue Impact	Appropriation Impact	Potential Impact *	Total Impact
LAW	HB0001 Feed bill	0	(6.700)	0	-6.7
	Total of Legislative Action	\$356.396	(\$437.320)	(\$2.649)	(\$83.573)

* Potential appropriations result from legislation changing the duties and functions of state agencies without a corresponding appropriation adjustment. These adjustments will be considered in House Bill 2 conference committee towards the end of the legislative session.

BUDGET COMPARISON METHODOLOGY

The legislature has traditionally used budget comparisons as a tool to assess budget performance and growth patterns in the state budget.

A great deal of interest, confusion, and controversy developed in recent years over the size of the state budget and methods of comparison. The state budget is complex, and the methods used to compute the comparisons can vary considerably.

In view of the confusion over comparisons, the 1997 legislature passed SB 35, sponsored by the Legislative Finance Committee (LFC), which established a statutory methodology (17-7-151, MCA) for calculating budget comparisons.

This section summarizes the major tenets of the statutory budget comparison. This methodology is intended for those comparisons that are made before, during, and immediately following legislative sessions to measure budget performance and growth. The major tenets of the methodology include:

1. The measure of budget performance will be total state expenditures of funds (projected) obtained from taxes, licenses, and certain fees. This includes federal funds.
2. The unit of measure for the comparisons will be actual expenditures in the first year plus appropriations in the second year of the current biennium, compared to appropriations in the next biennium.
3. The comparisons must be fair and balanced. That is, the same attributes are to be included on both sides of the comparison, and to be calculated using like methods.
4. The Legislative Fiscal Analyst and the Governor's Budget Director will work together to reach agreement on estimates to be included in the projections. Where there are irreconcilable differences, the LFD is to explain them as part of the budget analysis.
5. Both the Legislative Fiscal Analyst and the executive are required to use the statutory methodology for budget comparisons. This is to ensure consistency of application and avoid manipulation of comparisons.

The methodology includes all appropriations and projected expenditures, as stated in item number 1 above. Statute lists the types that must be included, but specifically excepts certain expenditures to eliminate duplicate costs, non-operational costs, transfers, enterprise operations, and fiduciary funds.

The following components (fund and appropriation type) are to be included in budget comparisons:

- General fund, state special, and federal revenue
- Proprietary funds that require an appropriation
- Cash appropriations for the Long Range Building Program
- Agency Funds – only tax distributions to local governments

The following components are to be excluded from the comparisons for the reasons shown:

- Eliminate double counting:
 - Debt Service Funds
 - Capital Project Funds (except cash appropriations)
 - Internal Service Funds (Proprietary)
 - Administrative/Agency Transfer Appropriations
- Eliminate Enterprise/Corporate Components:
 - Enterprise Funds (Proprietary)
 - University Funds - Unrestricted
 - University Funds - Other
- Eliminate Fiduciary Funds:
 - Agency Funds (except tax distributions)
 - Expendable Trust Funds
 - Non-expendable Trust Funds
 - Pension Trust Funds
- Non-Budgeted Items:
 - Non-cash accounting entries
 - Private Funds (state special revenue)

The Legislative Fiscal Division budget comparisons are presented on pages 58 and 59 of this volume, and were prepared using the prescribed methodology in 17-7-151, MCA.

INDEX TO OTHER LFD BUDGET REFERENCE DOCUMENTS

In addition to the *Legislative Budget Analysis – 2005 Biennium* (Volumes I through IV), there are several other reference documents that legislators and other interested parties can use as a source of information concerning budget and other fiscal matters. A limited number of reports of past biennia are available for reference in the LFD office (photo copies of pages of interest can be made). Training publications and brochures are available for distribution and on the LFD website. Check with an LFD staff member for assistance.

PREVIOUS REPORTS

The *Legislative Budget Analysis* is prepared at the beginning of each biennium and the *Legislative Fiscal Report* is published at the end of each session. The latter is a record of legislative actions that resulted from the enactment of House Bill 2 and other appropriation legislation, as well as revenue estimation and discussion of other fiscal issues.

- The *Legislative Budget Analysis* for all biennia beginning with the 1979 biennium is stored in the LFD office and in the State Library
- The *Legislative Fiscal Report* for all biennia beginning with the 1979 biennium is stored in the LFD office and in the State Library. Early versions of this report were titled the *Appropriations Report*

TRAINING PUBLICATIONS

Training material prepared by the LFD include the following:

- *Understanding State Finances and the Budgeting Process* (A Reference Manual for Legislators) is a helpful guide for persons wanting more detailed information concerning fiscal matters
- *HB 2 the Barbarian* (How to Make HB 2 Implement Public Policy as Determined by the Legislature) describes the intricacies of developing the general appropriations act

FISCAL POCKET GUIDES

A variety of brochures have been prepared to provide summary information concerning select topics important to legislators and other interested parties.

- | | |
|---|----------------------------|
| ○ Basic State Finances | Under Construction |
| ○ Bed Tax | ○ Coal Tax |
| ○ Fiscal Training Opportunities | ○ K-12 Education Funding |
| ○ General Fund Fiscal 2002 | ○ Local Government Funding |
| ○ Higher Education Funding | ○ Tobacco Trust |
| ○ Medicaid | |
| ○ Montana Highway Funding | |
| ○ Montana's Budgeting Process | |
| ○ Pertinent State Statistics | |
| ○ Resource Indemnity Trust | |
| ○ TANF (temporary assistance to needy families) | |

The LFD would welcome suggestions for other topics for pocket guides.



AGENCY BUDGET COMPARISONS BY FUND

GENERAL FUND

As defined in 17-2-102, MCA, the general fund "accounts for all financial resources except those required to be accounted for in another fund." The general fund funds the general operations of state government.

In Figure 1, general fund shows a slight increase of \$5.6 million, or less than 1 percent. This change is misleading, however, in that fiscal 2002 includes over \$45 million general fund for support to K-12 education reclassified as state special revenue and funded through statutory appropriation beginning in fiscal 2003. If this factor is accounted for, general fund increases \$51.2 million, or 2.3 percent, as shown in the last line of the table.

The change is a net of increases and decreases. As shown in table, the impact among various agencies differs widely. Major increases include the following.

- \$18.9 million for full biennium funding of the district courts - because the state assumed operation of the courts in fiscal 2003, only one year of costs are included in the 2003 biennium
- Increases in caseload in the Department of Corrections and the Department of Public Health and Human Services, partially offset by reductions in K-12 education enrollments
- Increases in the Department of Natural Resources and Conservation due to reductions in fiscal 2003 and transfers of general fund in that year to fiscal 2002 to fund fiscal 2002 fire costs
- A fund switch in fiscal 2003 that funded the Motor Vehicle Division in the Department of Justice with state special revenue - The executive proposes to fund the division with general fund in the 2005 biennium

These increases are significantly offset with numerous funding switches and other reductions within individual agencies.

Figure 1
General Fund Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2002	Adjusted Authorized Fiscal 2003	Total Exec. Budget Fiscal 2004	Total Exec. Budget Fiscal 2005	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	\$7,670,815	\$8,225,675	\$9,170,148	\$8,595,556	\$15,896,490	\$17,765,704	\$1,869,214	11.76%
2110	Judiciary	9,354,970	28,836,320	28,838,402	29,697,416	38,191,290	58,535,818	20,344,528	53.27%
3101	Governor's Office	4,046,816	4,321,411	4,341,641	4,278,051	8,368,227	8,619,692	251,465	3.00%
3202	Commissioner of Political Prac	331,665	354,800	322,913	317,525	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	334,795	323,345	0	0	658,140	0	(658,140)	-100.00%
3501	Office of Public Instruction	560,554,778	515,643,836	509,129,075	513,892,683	1,076,198,614	1,023,021,758	(53,176,856)	-4.94%
4107	Crime Control Division	1,794,097	1,814,472	1,645,059	1,647,129	3,608,569	3,292,188	(316,381)	-8.77%
4110	Department of Justice	23,647,394	16,660,622	23,343,919	22,962,721	40,308,016	46,306,640	5,998,624	14.88%
5101	Board of Public Education	166,141	175,677	157,206	154,935	341,818	312,141	(29,677)	-8.68%
5102	Commissioner of Higher Ed	138,589,358	134,409,216	136,687,535	136,687,537	272,998,574	273,375,072	376,498	0.14%
5113	School for the Deaf & Blind	3,506,495	3,407,295	3,506,495	3,506,495	6,913,790	7,012,990	99,200	1.43%
5114	Montana Arts Council	339,050	319,085	300,341	301,507	658,135	601,848	(56,287)	-8.55%
5115	Library Commission	1,774,096	1,794,981	1,895,629	1,639,776	3,569,077	3,535,405	(33,672)	-0.94%
5117	Historical Society	1,803,840	1,841,243	1,751,368	1,737,297	3,645,083	3,488,665	(156,418)	-4.29%
5201	Dept. of Fish, Wildlife & Parks	281,816	277,491	255,430	256,437	559,307	511,867	(47,440)	-8.48%
5301	Dept of Environmental Quality	3,546,942	3,932,764	3,548,343	3,534,154	7,479,706	7,082,497	(397,209)	-5.31%
5401	Department of Transportation	0	0	0	0	0	0	0	
5603	Department of Livestock	521,689	629,059	528,105	531,618	1,150,748	1,059,723	(91,025)	-7.91%
5706	Dept Nat Resource/Conservation	16,205,128	11,941,073	17,852,487	17,893,868	28,146,201	35,746,355	7,600,154	27.00%
5801	Department of Revenue	28,078,749	29,477,174	30,431,135	29,999,885	57,555,923	60,431,020	2,875,097	5.00%
6101	Department of Administration	4,195,717	4,059,191	3,774,470	3,803,948	8,254,908	7,578,418	(676,490)	-8.20%
6102	Appellate Defender	0	183,760	188,469	189,023	183,760	377,492	193,732	105.43%
6201	MT Dept of Agriculture	730,339	756,302	692,638	658,467	1,486,641	1,351,105	(135,536)	-9.12%
6401	Dept of Corrections	96,890,254	98,313,667	104,218,673	105,638,205	195,203,921	209,856,878	14,652,957	7.51%
6501	Department of Commerce	1,967,443	1,793,397	2,204,638	2,201,594	3,760,840	4,406,232	645,392	17.16%
6602	Labor & Industry	1,969,954	1,173,877	1,863,083	1,860,937	3,143,831	3,724,020	580,189	18.45%
6701	Dept of Military Affairs	2,974,227	3,067,978	3,163,957	3,140,598	6,042,205	6,304,555	262,350	4.34%
6901	Public Health & Human Services	260,341,982	265,184,033	262,301,509	268,902,398	525,526,015	531,203,907	5,677,892	1.08%
Total		\$1,171,618,550	\$1,138,917,744	\$1,152,112,668	\$1,164,029,760	\$2,310,536,294	\$2,316,142,428	\$5,606,134	0.24%
Adjusted for OPI Fund Switch		\$1,125,977,933	\$1,138,917,744	\$1,152,112,668	\$1,164,029,760	\$2,264,895,677	\$2,316,142,428	\$51,246,751	2.26%

STATE SPECIAL REVENUE

As defined in 17-2-102, MCA, the state special fund “consists of money from state and other non-federal sources deposited in the state treasury that is earmarked for the purposes of defraying particular costs of an agency, program, or function of state government and money from other non-state or non-federal sources that is restricted by law or by the terms of an agreement, such as a contract, trust agreement, or donation.”

In Figure 2, state special revenue increases \$189.4 million, or 24.9 percent. Almost 64 percent of the increase is attributable to increases in highways state special revenue account (HSSRA) spending in the Department of Transportation. The large increase is primarily due to the addition of bond proceeds to accelerate work on Highway 93, which adds \$87.6 million.

Other significant increases include:

- The Department of Public Health and Human Services due primarily to a change in allocation of some tobacco settlement proceeds to state special revenue accounts as a result of the passage of I-146, and additional county funds available as a result of intergovernmental transfers
- The Office of Public Instruction for a proposal to use funds diverted from the Treasure State Endowment Program for school facility payments
- The Department of Environmental Quality for potential bond payments
- The Department of Fish, Wildlife, and Parks due primarily to various adjustments funded with the general license account

Figure 2
State Special Revenue Fund Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2002	Adjusted Authorized Fiscal 2003	Total Exec. Budget Fiscal 2004	Total Exec. Budget Fiscal 2005	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
1104	Legislative Branch	\$2,178,043	\$1,903,935	\$2,340,000	\$1,683,479	\$4,081,978	\$4,023,479	(\$58,499)	-1.43%
1112	Consumer Counsel	1,022,534	1,233,970	1,210,683	1,218,271	2,256,504	2,428,954	172,450	7.64%
2110	Judiciary	710,015	1,782,519	2,643,354	2,619,795	2,492,534	5,263,149	2,770,615	111.16%
2115	Mt.Chiropractic Legal Panel	3,776	15,000	15,000	15,000	18,776	30,000	11,224	59.78%
3101	Governor's Office	247,969	454,545	586,105	594,214	702,514	1,180,319	477,805	68.01%
3401	State Auditor's Office	3,171,444	3,488,146	4,227,117	4,285,010	6,659,590	8,512,127	1,852,537	27.82%
3501	Office of Public Instruction	1,092,119	942,620	5,041,565	5,304,373	2,034,739	10,345,938	8,311,199	408.47%
4107	Crime Control Division	0	0	0	0	0	0	0	
4110	Department of Justice	21,081,629	30,592,258	29,549,768	24,507,428	51,673,887	54,057,196	2,383,309	4.61%
4201	Public Service Regulation	2,533,459	3,381,868	2,773,630	2,658,407	5,915,327	5,432,037	(483,290)	-8.17%
5101	Board of Public Education	143,155	181,194	185,003	186,852	324,349	371,855	47,506	14.65%
5102	Commissioner of Higher Ed	12,618,636	13,066,460	13,101,000	13,228,999	25,685,096	26,329,999	644,903	2.51%
5113	School for the Deaf & Blind	235,065	346,065	341,676	342,082	581,130	683,758	102,628	17.66%
5114	Montana Arts Council	140,829	137,416	158,100	153,223	278,245	311,323	33,078	11.89%
5115	Library Commission	666,421	622,645	814,815	785,700	1,289,066	1,600,515	311,449	24.16%
5117	Historical Society	426,471	580,876	540,333	544,316	1,007,347	1,084,649	77,302	7.67%
5201	Dept. of Fish, Wildlife & Parks	33,971,373	36,649,336	39,934,461	38,882,011	70,620,709	78,816,472	8,195,763	11.61%
5301	Dept of Environmental Quality	22,494,902	41,336,025	53,319,394	15,520,037	63,830,927	68,839,431	5,008,504	7.85%
5401	Department of Transportation	149,258,584	194,283,614	222,102,788	242,424,063	343,542,198	464,526,851	120,984,653	35.22%
5603	Department of Livestock	6,622,614	7,075,829	7,104,865	7,029,072	13,698,443	14,133,937	435,494	3.18%
5706	Dept Nat Resource/Conservation	14,617,396	14,349,317	18,888,500	16,297,805	28,966,713	35,186,305	6,219,592	21.47%
5801	Department of Revenue	424,485	444,154	549,156	553,163	868,639	1,102,319	233,680	26.90%
6101	Department of Administration	2,673,474	2,852,132	3,612,596	3,639,482	5,525,606	7,252,078	1,726,472	31.24%
6102	Appellate Defender	178,910	0	0	0	178,910	0	(178,910)	-100.00%
6201	MT Dept of Agriculture	7,156,170	8,151,113	8,469,155	8,374,611	15,307,283	16,843,766	1,536,483	10.04%
6401	Dept of Corrections	1,668,004	1,725,843	2,156,131	2,153,325	3,393,847	4,309,456	915,609	26.98%
6501	Department of Commerce	2,556,211	2,739,941	2,763,712	1,750,416	5,296,152	4,514,128	(782,024)	-14.77%
6602	Labor & Industry	22,630,948	21,344,366	24,722,009	24,747,720	43,975,314	49,469,729	5,494,415	12.49%
6701	Dept of Military Affairs	151,344	409,529	1,628,074	1,707,020	560,873	3,335,094	2,774,221	494.63%
6901	Public Health & Human Services	23,836,105	35,005,021	38,738,195	40,334,583	58,841,126	79,072,778	20,231,652	34.38%
Total		\$334,512,085	\$425,095,737	\$487,517,185	\$461,540,457	\$759,607,822	\$949,057,642	\$189,449,820	24.94%

FEDERAL SPECIAL REVENUE

As defined in 17-2-102, MCA, the federal special fund "consists of money deposited in the treasury from federal sources, including trust income, that is used for the operation of state government."

Federal revenue increases by \$202.5 million, or 7.6 percent. Two near offsetting accounting adjustments skew the totals in two agencies.

- In the Department of Commerce, federal Housing and Urban Development (HUD) funding was reduced by over \$80 million. The funds will still be received by the state, but will be accounted for as enterprise funds, which do not require an appropriation.
- Food stamps benefits, which were previously unbudgeted, must now be accounted for as expenditures and appropriated in HB 2. This change adds \$69.5 million to the budget of the Department of Public Health and Human Services

Significant changes are in the following agencies:

- About \$127 million in the Department of Public Health and Human Services for caseload adjustments, refinancing efforts, and the receipt of expanded and new federal grants. This increase is the net of reduced federal funds due to the proposed reduction in many human services programs.
- \$38.2 million for new and expanded grants in the Office of Public Instruction, including significant new funds for the federal "No Child Left Behind" initiative
- \$12.1 million in the Department of Fish, Wildlife, and Parks for a variety of new and expanded programs and operational increases
- \$11.8 million in the Department of Transportation for construction and planning, and for airport rehabilitation

Figure 3
Federal Special Revenue Fund Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2002	Adjusted Authorized Fiscal 2003	Total Exec. Budget Fiscal 2004	Total Exec. Budget Fiscal 2005	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 05 Biennium
2110	Judiciary	\$373,587	\$419,664	\$390,684	\$390,018	\$793,251	\$780,702	(\$12,549)	-1.58%
3101	Governor's Office	45,279	2,046,926	2,110,444	110,427	2,092,205	2,220,871	128,666	6.15%
3501	Office of Public Instruction	93,898,407	119,309,035	123,391,845	128,036,978	213,207,442	251,428,823	38,221,381	17.93%
4107	Crime Control Division	10,303,972	12,516,813	10,422,968	10,418,938	22,820,785	20,841,906	(1,978,879)	-8.67%
4110	Department of Justice	2,700,049	3,152,297	3,546,780	3,537,874	5,852,346	7,084,654	1,232,308	21.06%
4201	Public Service Regulation	12,507	14,193	13,782	13,634	26,700	27,416	716	2.68%
5102	Commissioner of Higher Ed	39,411,623	53,860,436	42,020,644	45,022,470	93,272,059	87,043,114	(6,228,945)	-6.68%
5113	School for the Deaf & Blind	88,898	88,898	96,696	96,696	177,796	193,392	15,596	8.77%
5114	Montana Arts Council	464,530	490,471	599,116	599,086	955,001	1,198,202	243,201	25.47%
5115	Library Commission	936,567	1,074,826	1,705,694	780,694	2,011,393	2,486,388	474,995	23.62%
5117	Historical Society	683,747	898,276	740,557	741,402	1,582,023	1,481,959	(100,064)	-6.33%
5201	Dept. of Fish, Wildlife & Parks	11,077,892	11,777,540	18,199,723	16,781,024	22,855,432	34,980,747	12,125,315	53.05%
5301	Dept of Environmental Quality	16,216,721	21,180,590	26,289,180	21,408,547	37,397,311	47,697,727	10,300,416	27.54%
5401	Department of Transportation	283,381,456	369,141,124	343,881,402	320,437,451	652,522,580	664,318,853	11,796,273	1.81%
5603	Department of Livestock	524,873	558,424	1,575,886	1,579,399	1,083,297	3,155,285	2,071,988	191.27%
5706	Dept Nat Resource/Conservation	1,683,292	1,877,287	1,947,167	1,865,297	3,560,579	3,812,464	251,885	7.07%
5801	Department of Revenue	2,328,482	2,487,603	2,372,117	2,362,317	4,816,085	4,734,434	(81,651)	-1.70%
6101	Department of Administration	503,119	65,393	2,912,708	662,594	568,512	3,575,302	3,006,790	528.89%
6201	MT Dept of Agriculture	946,465	2,134,693	3,550,539	1,547,546	3,081,158	5,098,085	2,016,927	65.46%
6401	Dept of Corrections	750,280	985,955	397,053	397,053	1,736,235	794,106	(942,129)	-54.26%
6501	Department of Commerce	39,516,074	68,699,644	17,348,691	13,514,371	108,215,718	30,763,062	(77,452,656)	-71.57%
6602	Labor & Industry	31,976,879	39,352,162	35,417,330	35,398,105	71,329,041	70,815,435	(513,606)	-0.72%
6701	Dept of Military Affairs	6,982,250	7,360,862	13,004,353	13,003,140	14,343,112	26,007,493	11,664,381	81.32%
6901	Public Health & Human Services	643,498,934	745,531,834	779,982,932	805,322,481	1,389,030,768	1,585,305,413	196,274,645	14.13%
Total		\$1,188,305,883	\$1,465,024,946	\$1,431,818,291	\$1,424,027,542	\$2,653,330,829	\$2,855,845,833	\$202,515,004	7.63%

PROPRIETARY REVENUE

As defined in 17-2-102, MCA, proprietary funds are designated as either enterprise or internal service funds. Enterprise funds "account for operations: (A) that are financed and operated in a manner similar to private business enterprises whenever the intent of the legislature is that costs (i.e. expenses, including depreciation) of providing goods or services to that general public on a continuing basis are to be financed or recovered primarily through user charges; or (B) whenever the legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes." Internal service funds "account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost reimbursed basis."

Statute does not require that most proprietary funds be appropriated. Therefore, any increases in the programs supported with these proprietary funds are not reflected in the table.

Proprietary funds show an overall decrease primarily due to the elimination of a debt service expense in the Montana State Lottery.

Figure 4
Proprietary Fund Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2002	Adjusted Authorized Fiscal 2003	Total Exec. Budget Fiscal 2004	Total Exec. Budget Fiscal 2005	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 05 Biennium - 03 Biennium	% Change 03 Biennium 05 Biennium
3501	Office of Public Instruction	\$90,791	\$100,000	\$0	\$0	\$190,791	\$0	(\$190,791)	-100.00%
4110	Department of Justice	689,888	784,385	809,244	804,574	1,474,273	1,613,818	139,545	9.47%
5117	Historical Society	772,904	879,076	896,085	899,181	1,651,980	1,795,266	143,286	8.67%
5201	Dept. of Fish, Wildlife & Parks	0	0	0	0	0	0	0	
5301	Dept of Environmental Quality	0	0	0	0	0	0	0	
5401	Department of Transportation	0	0	0	0	0	0	0	
5801	Department of Revenue	1,975,037	2,009,392	1,993,383	1,999,608	3,984,429	3,992,991	8,562	0.21%
6101	Department of Administration	7,862,145	8,822,152	8,593,053	7,338,724	16,684,297	15,931,777	(752,520)	-4.51%
6201	MT Dept of Agriculture	241,801	334,858	320,214	321,521	576,659	641,735	65,076	11.29%
6401	Dept of Corrections	420,102	595,029	538,816	549,311	1,015,131	1,088,127	72,996	7.19%
6501	Department of Commerce	0	0	0	0	0	0	0	
6602	Labor & Industry	43,126	62,286	67,956	67,851	105,412	135,807	30,395	28.83%
Total		\$12,095,794	\$13,587,178	\$13,218,751	\$11,980,770	\$25,682,972	\$25,199,521	(\$483,451)	-1.88%

ALL FUNDS

The final comparison table is a composite by agency of the preceding tables, and shows an increase of \$396.3 million, or almost 7 percent. Adjusted for the interest and income revenues for K-12 education, the increase is \$441.9 million, or 7.8 percent.

Figure 5
All Funds Comparison
03 Biennium Versus Executive Budget 05 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2002	Adjusted Authorized Fiscal 2003	Total Exec. Budget Fiscal 2004	Total Exec. Budget Fiscal 2005	Total Adjusted Fiscal 02-03	Total Exec. Budget Fiscal 04-05	Difference 03 Biennium - 03 Biennium	% Change 03 Biennium
1104	Legislative Branch	\$9,848,858	\$10,129,610	\$11,510,148	\$10,279,035	\$19,978,468	\$21,789,183	\$1,810,715	9.06%
1112	Consumer Counsel	1,022,534	1,233,970	1,210,683	1,218,271	2,256,504	2,428,954	172,450	7.64%
2110	Judiciary	10,438,572	31,038,503	31,872,440	32,707,229	41,477,075	64,579,669	23,102,594	55.70%
2115	Mt.Chiropractic Legal Panel	3,776	15,000	15,000	15,000	18,776	30,000	11,224	59.78%
3101	Governor's Office	4,340,064	6,822,882	7,038,190	4,982,692	11,162,946	12,020,882	857,936	7.69%
3202	Commissioner of Political Prac	331,665	354,800	322,913	317,525	686,465	640,438	(46,027)	-6.70%
3401	State Auditor's Office	3,506,239	3,811,491	4,227,117	4,285,010	7,317,730	8,512,127	1,194,397	16.32%
3501	Office of Public Instruction	655,636,095	635,995,491	637,562,485	647,234,034	1,291,631,586	1,284,796,519	(6,835,067)	-0.53%
4107	Crime Control Division	12,098,069	14,331,285	12,068,027	12,066,067	26,429,354	24,134,094	(2,295,260)	-8.68%
4110	Department of Justice	48,118,960	51,189,562	57,249,711	51,812,597	99,308,522	109,062,308	9,753,786	9.82%
4201	Public Service Regulation	2,545,966	3,396,061	2,787,412	2,672,041	5,942,027	5,459,453	(482,574)	-8.12%
5101	Board of Public Education	309,296	356,871	342,209	341,787	666,167	683,996	17,829	2.68%
5102	Commissioner of Higher Ed	190,619,617	201,336,112	191,809,179	194,939,006	391,955,729	386,748,185	(5,207,544)	-1.33%
5113	School for the Deaf & Blind	3,830,458	3,842,258	3,944,867	3,945,273	7,672,716	7,890,140	217,424	2.83%
5114	Montana Arts Council	944,409	946,972	1,057,557	1,053,816	1,891,381	2,111,373	219,992	11.63%
5115	Library Commission	3,377,084	3,492,452	4,416,138	3,206,170	6,869,536	7,622,308	752,772	10.96%
5117	Historical Society	3,686,962	4,199,471	3,928,343	3,922,196	7,886,433	7,850,539	(35,894)	-0.46%
5201	Dept. of Fish, Wildlife & Parks	45,331,081	48,704,367	58,389,614	55,919,472	94,035,448	114,309,086	20,273,638	21.56%
5301	Dept of Environmental Quality	42,258,565	66,449,379	83,156,917	40,462,738	108,707,944	123,619,655	14,911,711	13.72%
5401	Department of Transportation	432,640,040	563,424,738	565,984,190	562,861,514	996,064,778	1,128,845,704	132,780,926	13.33%
5603	Department of Livestock	7,669,176	8,263,312	9,208,856	9,140,089	15,932,488	18,348,945	2,416,457	15.17%
5706	Dept Nat Resource/Conservation	32,505,816	28,167,677	38,688,154	36,056,970	60,673,493	74,745,124	14,071,631	23.19%
5801	Department of Revenue	32,806,753	34,418,323	35,345,791	34,914,973	67,225,076	70,260,764	3,035,688	4.52%
6101	Department of Administration	16,167,510	16,731,923	19,404,369	15,963,117	32,899,433	35,367,486	2,468,053	7.50%
6102	Appellate Defender	178,910	183,760	188,469	189,023	362,670	377,492	14,822	4.09%
6201	MT Dept of Agriculture	9,074,775	11,376,966	13,032,546	10,902,145	20,451,741	23,934,691	3,482,950	17.03%
6401	Dept of Corrections	99,728,640	101,620,494	107,310,673	108,737,894	201,349,134	216,048,567	14,699,433	7.30%
6501	Department of Commerce	44,039,728	73,232,982	22,217,041	17,466,381	117,272,710	39,683,422	(77,589,288)	-66.16%
6602	Labor & Industry	56,620,907	61,932,691	62,070,378	62,074,613	118,553,598	124,144,991	5,591,393	4.72%
6701	Dept of Military Affairs	10,107,821	10,838,369	17,796,384	17,850,758	20,946,190	35,647,142	14,700,952	70.18%
6901	Public Health & Human Services	927,677,021	1,045,720,888	1,081,022,636	1,114,559,462	1,973,397,909	2,195,582,098	222,184,189	11.26%
Total		\$2,707,465,367	\$3,043,558,660	\$3,085,178,437	\$3,062,096,898	\$5,751,024,027	\$6,147,275,335	\$396,251,308	6.89%
Adjusted for OPI Fund Switch		\$2,661,824,750	\$3,043,558,660	\$3,085,178,437	\$3,062,096,898	\$5,705,383,410	\$6,147,275,335	\$441,891,925	7.75%



TRUST FUND BALANCES

Montana has a number of constitutional and statutory trusts that provide interest income (over \$82 million per year) to fund state government operations. While the legislature spent the principal of the education trust, slowed the flow of revenue into the coal tax trust and parks acquisition trust, and eliminated the growth of the resource indemnity tax trust, substantial balances remain.

1999 LEGISLATURE

The Fifty-sixth Legislature in the 1999 session reduced the rate of growth in many of the trusts by passing legislation that redirected incoming revenues. The Fifty-sixth Legislature passed legislation that reduced the fiscal 2001 ending fund balance for all trusts combined by an estimated \$26 million when compared with pre-session estimates. The reduction in revenue growth was the greatest for the Permanent Coal Tax Trust, the Treasure State Endowment, and the Common School Fund. The legislature substantially enhanced the revenue growth into the noxious weed trust and marginally increased revenue into the Resource Indemnity Trust.

2001 LEGISLATURE

The Fifty-seventh Legislature in the 2001 session enacted several measures impacting state trust funds.

1. House Bill 444 appropriated to the Department of Justice \$990,000 for the 2003 biennium as a loan from the coal severance permanent fund. The purpose of the appropriation is to conduct the natural resource damage assessment and litigation and to pursue Montana's remaining natural resource damage claims and any appeals against the Atlantic Richfield Company. The resulting loss in transfers of trust interest earnings to the general fund;
2. House Bill 610, beginning fiscal 2004, reduces the amount of total coal severance tax collections deposited in the treasure state endowment fund from 37.5 percent to percent 25.0 percent and increases the amount deposited to the permanent fund from 0 percent to 12.5 percent;
3. the passage of Senate Bill 495 resulted in the sale of the common school trust's mineral production rights and the diversion of future royalties that would have been deposited in the trust. As a result of the sale, the balance of the common school trust increased by \$46.4 million, but future growth in the trust was severely curtailed. For further information and analysis of Senate Bill 495, contact the Legislative Fiscal Division for a copy of the two-part report: "Senate Bill 495 – Implementation, Impacts and Implications";
4. the resource indemnity trust reached \$100 million in fiscal 2002, any amount in excess of \$100 million because available for the legislature to appropriate. In House Bill 2, the legislature appropriated all the estimated \$1.1 million excess in fiscal 2003, thus reducing the trust balance.

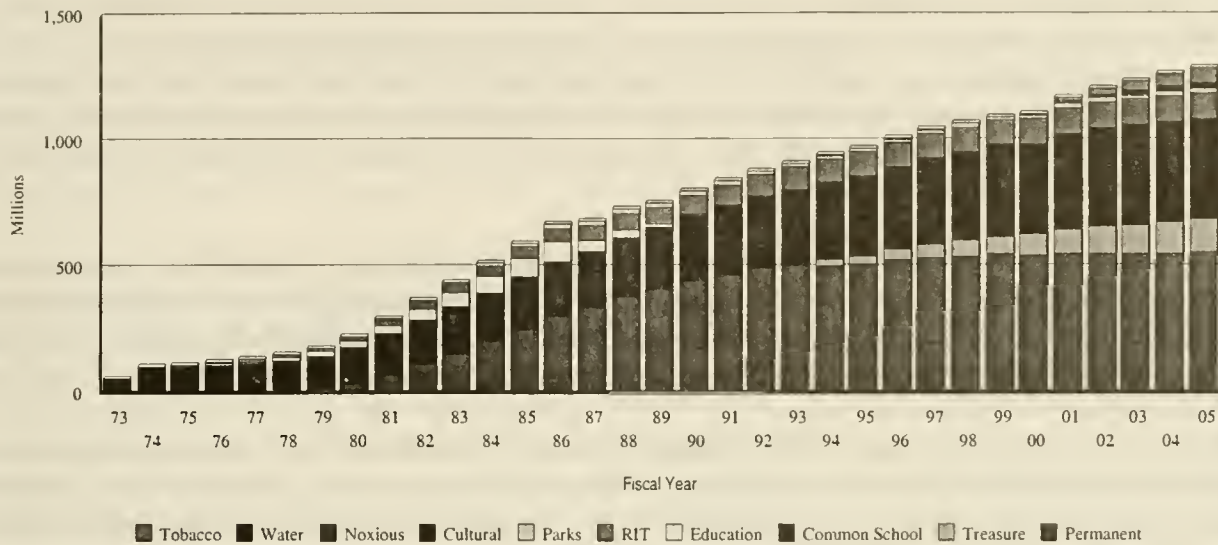
Figures 1 and 2 show the history of the ten major trusts since fiscal 1973. Forecasted amounts are shown for fiscal years 2003, 2004 and 2005, and are based on assumptions contained in House Joint Resolution 2 (HJR 2).

Following is a description of each trust and the income it generates. Also shown are expected interest earnings from each trust in fiscal years 2003, 2004, and 2005.

Figure 1
Selected Trust Fund Balances
Including Projected Investment Earnings

Fiscal Year	Permanent Coal Tax Trust Fund	Treasure St Endowment Trust Fund	Common School Trust Fund	Education Trust Fund	Resource Indemnity Trust Fund	Parks Acquisition Trust Fund	Cultural Protection Trust Fund	Noxious Weed Trust Fund	Regional Water Trust Fund	Tobacco Trust Fund	Total Trust Funds
A 73	0	0	64,223,773	0	0	0	0	0	0	0	64,223,773
A 74	0	0	108,998,870	0	1,141,385	0	0	0	0	0	110,140,255
A 75	0	0	113,064,188	0	3,287,456	0	0	0	0	0	116,351,644
A 76	0	0	117,849,628	2,227,793	5,552,291	278,725	0	0	0	0	125,908,437
A 77	0	0	123,281,528	6,039,530	8,232,247	758,308	0	0	0	0	138,311,613
A 78	6,268,262	0	129,949,247	8,983,763	10,646,851	1,174,356	0	0	0	0	157,022,479
A 79	16,940,538	0	137,716,735	12,339,549	12,574,209	1,475,732	0	0	0	0	181,046,763
A 80	39,964,765	0	147,527,943	23,905,146	16,204,531	3,565,371	0	0	0	0	231,167,756
A 81	75,187,459	0	163,163,556	33,624,170	21,165,464	5,325,746	0	0	0	0	298,466,395
A 82	118,336,314	0	176,467,865	44,338,477	28,328,946	7,480,418	0	0	0	0	374,952,020
A 83	158,358,806	0	189,390,417	52,665,410	36,181,889	9,481,542	0	0	0	0	446,078,064
A 84	202,936,358	0	201,319,109	60,925,268	42,986,128	11,565,460	0	0	0	0	519,732,323
A 85	252,420,524	0	214,764,544	70,500,922	47,396,179	13,859,181	0	0	0	0	598,941,350
A 86	309,384,250	0	217,677,906	79,761,708	53,039,675	16,222,131	0	443,184	0	0	676,528,854
A 87	339,883,180	0	227,687,073	44,091,429	56,861,627	16,613,608	0	824,550	0	0	685,961,467
A 88	381,180,287	0	239,553,633	33,671,110	61,750,961	16,581,042	0	1,070,972	0	0	733,808,005
A 89	411,838,993	0	254,128,428	8,651,477	66,665,000	16,608,706	0	1,320,720	0	0	759,213,324
A 90	446,511,416	0	268,496,362	0	72,811,618	17,936,701	0	1,688,370	0	0	807,444,467
A 91	470,322,655	0	280,326,496	0	77,324,921	18,882,548	0	2,121,973	0	0	848,978,593
A 92	496,465,569	0	291,753,603	0	82,489,898	12,588,366	7,051,506	2,584,254	0	0	892,933,196
A 93	511,474,640	0	300,782,863	0	86,890,369	12,538,119	6,863,579	2,534,844	0	0	921,084,414
A 94	511,754,471	20,520,830	310,735,129	0	89,316,268	12,538,119	7,025,290	2,518,875	0	0	954,408,982
A 95	515,470,287	31,793,125	321,265,835	0	91,614,674	12,538,119	7,296,373	2,544,390	0	0	982,522,803
A 96	530,144,251	42,262,548	331,630,225	0	93,152,864	12,998,633	7,518,157	2,502,197	0	0	1,020,208,875
A 97	538,223,210	52,210,048	347,298,490	0	94,584,643	13,483,000	3,846,000	2,527,953	0	0	1,052,173,344
A 98	545,789,038	61,800,580	355,329,490	0	95,582,249	14,005,728	3,852,201	2,537,621	0	0	1,078,896,907
A 99	555,204,609	68,334,808	365,188,709	0	94,991,658	14,399,076	3,852,202	2,471,388	0	0	1,104,442,450
A 00	553,031,020	81,347,120	359,661,156	0	96,404,163	14,834,592	4,050,384	3,635,000	3,441,977	0	1,116,405,412
A 01	557,477,352	92,182,012	384,741,584	0	100,373,547	15,376,300	4,257,671	4,760,000	7,389,930	10,819,202	1,177,377,598
A 02	555,718,038	105,383,384	394,132,998	0	102,065,653	15,777,802	4,454,360	4,760,000	11,914,241	23,203,091	1,217,409,567
Fund Balance Forecast											
F 03	555,718,000	116,352,000	396,176,000	0	99,999,990	15,778,000	4,454,000	4,760,000	15,570,000	36,061,000	1,244,868,990
F 04	559,342,000	123,600,000	398,219,000	0	99,999,990	16,167,000	4,647,000	4,760,000	19,194,000	47,597,000	1,273,525,990
F 05	562,715,000	130,345,000	400,262,000	0	99,999,990	16,531,000	4,828,000	4,760,000	22,567,000	59,494,000	1,301,501,990
Investment Earnings Forecast											
F 03	36,825,000	7,201,000	26,503,000	0	7,376,000	1,114,000	314,000	333,200	1,151,000	1,741,000	82,558,200
F 04	37,249,000	7,871,000	26,693,000	0	7,377,000	1,127,000	322,000	333,200	1,404,000	2,464,000	84,840,200
F 05	37,920,000	8,472,000	26,922,000	0	7,379,000	1,153,000	337,000	333,200	1,670,000	3,253,000	87,439,200

Figure 2
Cumulative Balances of Trust Funds



**LFD
COMMENT**

Various restrictions, either constitutional or statutory, prohibit or restrict the expenditure of all or a portion of trust fund balances. For example, the Constitution prohibits expenditure of money in the resource indemnity tax trust until the balance reaches \$100 million. Since the balance of this trust is at this limit, any additional trust balance can be spent. Figure 3 shows the 9 trust funds, their fiscal 2002 balances, and the restrictions for spending the balances.

Figure 3
Selected Trust Funds
Balances and Restrictions

Restriction/Trust Fund	Fiscal 2002 Balance	Restrictions
Statutory		
Parks Acquisition Trust	\$15,777,802	None
Noxious Weed Management	4,760,000	Except for \$2.25 million, balance can be spent
Cultural Trust	<u>4,454,360</u>	None
Subtotal	\$24,992,162	
Constitutional		
Permanent Coal Severance Tax Trust	\$555,718,038	Inviolate, except by 3/4 vote of each house
Common School Trust	394,132,998	Inviolate, guaranteed by state against loss or diversion
Treasure State Endowment Trust	105,383,384	Inviolate except by 3/4 vote of each house
Resource Indemnity Tax Trust	102,065,653	Inviolate, \$100 million guaranteed by state against loss or diversion
Tobacco Settlement Trust	23,203,091	Inviolate, except by 2/3 vote of each house
TSE Regional Water System Trust	<u>11,914,241</u>	Inviolate, except by 3/4 vote of each house
Subtotal	\$1,192,417,405	
Total	<u>\$1,217,409,567</u>	

CONSTITUTIONAL TRUSTS

Permanent Coal Tax Trust

Article IX, Section 5 of the Montana Constitution requires that at least 50 percent of all coal severance tax revenue be deposited in a permanent coal tax trust fund, and that the principal of the trust "shall forever remain inviolate unless appropriated by a vote of three-fourths of the members of each house of the legislature." By statute, interest earned on this trust that is not earmarked for other programs is distributed 100 percent to the general fund. As described below, some of the interest earned on the trust is earmarked for other programs.

The interest earned on the permanent coal tax trust fund is an important general fund revenue source. During the period of fiscal 1981 through fiscal 2002, \$750.7 million in interest from this trust was deposited in the combined general fund/school equalization account (SEA). In fiscal 2002, permanent coal tax trust fund interest provided 3.0 percent of total revenue to the general fund.

Initiative 95, approved by voters in 1982, required that 25 percent of the revenue deposited in the permanent coal tax trust after June 30, 1983, be placed in the in-state investment trust fund for investment in the Montana economy "with special emphasis on investments in new or expanding locally owned enterprises." The 1991 legislature: 1) eliminated separate accounting for the in-state investment trust; and 2) instructed the Board of Investments to "endeavor to invest up to 25 percent of the permanent coal tax trust fund" in the Montana economy.

The 1989 and 1991 legislatures gave authority to the Montana Science and Technology Alliance (MSTA) for the use of \$12.5 million from the in-state investment fund for investment in new and expanding technology-based Montana businesses and for research and development project loans. The 1993 legislature authorized MSTTA to invest an additional \$11.0 million from the in-state investment program.

The payback of principal from MSTTA loans returns to the trust. Before July 1, 1993, the interest from MSTTA loans was distributed in the same manner as other interest earned on the permanent coal tax trust fund. House Bill 394, enacted by the 1993 legislature, created a special revenue account into which all interest earned from MSTTA loans is deposited and from which MSTTA expenses will be paid, with the balance returning to the trust.

The 1991 legislature also appropriated \$3.25 million from the permanent coal tax trust fund for the Microbusiness Development Act. These funds provided capital to microbusiness development corporations that provide loans and technical assistance to qualified small businesses. Interest earnings and loan repayments were retained by the program to finance administrative costs and future loans.

During the January 1992 special session, the legislature authorized the creation of a school bond contingency loan fund within the permanent coal tax trust fund. The contingency fund provided up to \$25.0 million in loan guarantees for school district bonds certified by the Department of Administration as meeting certification standards, but for which subsequent litigation prevents collection of property taxes levied for debt service. School districts are required to repay any guarantee funds used. Interest on the contingency fund is distributed in the same manner as all other interest earned on the permanent coal tax trust fund. This legislation expired on January 1, 1993. House Bill 667, passed during the 1993 legislative session, provides Guaranteed Tax Base (GTB) aid to certain schools with

bonds outstanding or bond issues contemplated. The source of funding for GTB aid was the school equalization account (SEA). The contingency fund will continue to exist until calendar 2012 when the bonds will be retired.

In the June 1992 election, voters approved a referendum to create the treasure state endowment fund (TSEF) within the permanent coal tax trust fund. The fund received a \$10.0 million grant from the trust principal in fiscal 1994 and will receive half the funds deposited in the trust during fiscal 1995 through fiscal 2013. Interest earned on the TSEF is used to finance local infrastructure projects, as prioritized by the Departments of Commerce and Natural Resources and Conservation and authorized by the legislature.

During the November 1993 special session, the legislature authorized SB 4 that required the cash balance in the coal tax bond fund as of July 1, 1993 be deposited in the permanent coal tax trust fund. The total amount transferred was \$31.1 million. SB 4 also changed the distribution mechanism by requiring the 50 percent coal severance tax revenue allocation be deposited in the TSEF and the permanent coal tax trust fund on an equal basis. Prior to SB 4, coal severance tax revenue earned on production taking place beginning July 1, 1993, was to have been deposited in TSEF. In the following fiscal year, one-half of the previous year's inflow was to have been deposited in the permanent coal tax trust fund, and the TSEF was to retain the rest. Without SB 4, the permanent coal tax trust fund would not have received any coal severance tax revenue during fiscal 1994.

The 1993 legislature passed HB 401, which authorized a loan to the Department of Environmental Quality (DEQ), (formerly the Department of Health and Environmental Sciences) from the permanent coal tax trust fund for technical, litigation, and administrative expenses associated with the natural resource damage litigation suit against the Atlantic Richfield Company in the Clark Fork River Basin. The amount of the loan was \$2.6 million for the 1995 biennium and \$5.2 million to repay principal and interest to the general fund for litigation costs incurred in the 1993 biennium. As of December 1994, \$6.3 million had been withdrawn from the permanent coal tax trust to pay for litigation expenses. Since then, the case has been settled and money returned to the permanent trust (see the write-up of HB 110 enacted by the 1997 legislature).

1995 Legislative Action

HB 305 authorized a loan to the Department of Justice from the permanent coal tax trust for the purpose of conducting the litigation and natural resource claims against the Atlantic Richfield Company in the Clark Fork River Basin. The amount of the loan was \$2.4 million for the 1997 biennium. The bill also extended loans made for the same purpose during the 1995 biennium. As of May 1998, \$9.8 million had been withdrawn from the permanent coal tax trust to pay litigation expenses.

HB 354 expanded appropriations for the Microbusiness Financing Act, which provides loans to businesses employing less than ten employees and generating less than \$500,000 in gross revenue annually. The expansion of this program doubled the previous appropriation to \$3.25 million of investable coal tax trust funds made available to the Microbusiness Finance Program in the Department of Commerce. Beginning July 1, 1995, HB 354 also increased maximum loan amounts per individual loan from \$20,000 to \$35,000. The program provides financing for working capital assets and fixed asset acquisition with more flexible repayment terms than those offered by commercial institutions. Payback of interest and principal of the loan amounts are used for administrative purposes and for financing new microbusiness loans.

SB 38 authorized the Job Investment Act under which the Department of Commerce may loan a portion of the permanent coal tax trust to businesses to create and retain jobs in Montana. A loan to a qualified business may not exceed \$500,000, and the department is to report annually to the Revenue and Taxation Committee. The legislation also reduced the amount of permanent coal tax trust funds that the Board of Investments allows the Montana Board of Science and Technology Development to invest in seed capital loans and mezzanine loans from \$15.5 million to \$12.5 million. The bill also increased the amount of permanent coal tax trust funds available for research and development projects from \$8.1 million to \$11.1 million. In the past, these funds were used primarily as loans to the University System. Under SB 38, these funds were granted to the University System for research and development projects. As of October 1, 1998, \$25.7 million had been loaned or granted to Montana businesses and the university system.

SB 83 abolished the distribution of coal trust interest to the SEA. Under previous law, 15 percent of coal trust interest earnings were deposited in the SEA and 85 percent in the general fund. As a result of SB 83, 100 percent of coal trust interest earnings are deposited in the general fund in fiscal 1996 and beyond.

1997 Legislative Action

HB 110 appropriated to the Department of Justice \$2.5 million in state special revenue to be used for continuing litigation expenses associated with the Atlantic Richfield case. The appropriation was for expenses incurred during the 1999 biennium, and, upon settlement of the case, the amount used plus interest was to be returned to the general fund. The case was settled in June of 1998 for \$215 million. On June 24, 1998, \$15 million was deposited into Short-Term Investment Pool (STIP) for payment to the permanent trust and the general fund. In the middle of October 1998, \$12.2 million was transferred to the permanent trust, including \$9.8 million in principal and \$2.4 million in interest. In the middle of November 1998, \$1.9 million was transferred to the general fund. This transfer was made up of principal (\$1.4 million) and interest (\$0.5 million) and constituted repayment of general fund loans going back to fiscal 1983 when the case began.

The legislature amended the allocation of coal severance taxes under 15-35-108, MCA. In HB 14, the 1997 legislature authorized the issuance of general obligation bonds to fund the purchase of Virginia City and Nevada City properties. In HB 5, the legislature allocated 1.3 percent of coal severance tax revenue to pay the debt service on the bonds, which have a term of ten years. Coal tax revenue will be distributed to the Long-Range Building Program (LRBP) debt service account for fiscal 1998 through 2007. This allocation diverts coal severance tax revenue that would otherwise be deposited in the general fund. Based on revenue estimates in HJR 2, this change in allocation resulted in a loss to the general fund of \$0.5 million in fiscal 1998 and 1999. Once the ten-year period has expired, the 1.3 percent allocation will revert to the general fund.

HB 5 also eliminated the 0.63 percent distribution of coal severance tax to the cultural and aesthetic (C&A) trust during the 1999 biennium only. The legislature appropriated \$3.9 million from the cultural trust for the immediate purchase of Virginia City and Nevada City. This appropriation resulted in a loss of trust interest revenue that otherwise would have been used to fund C&A projects during the 1999 biennium. In order to compensate for the lost interest, the legislature allocated 0.87 percent of coal severance tax revenue to the C&A projects account and eliminated the 0.63 percent of coal severance tax revenue that had been deposited in the cultural trust. The remaining 0.24 percent of coal taxes allocated to the C&A project account was previously part of the flow into the general fund. Based on revenue estimates in HJR 2, this part of HB 5 resulted in a loss to the general fund of \$91,736 and

\$93,195 for fiscal 1998 and 1999, respectively. After the 1999 biennium, similar amounts of coal severance tax revenue were diverted from the C&A projects account and again flowed to the general fund.

HB 578 abolished the Montana Board of Science and Technology beginning July 1, 1999. The amount of money committed for research and development (\$11.1 million) and for seed capital loans (\$12.5 million) was allowed to be disbursed until July 1, 1999. Any money under these caps that has not been committed, except for \$915,000, was returned to the coal tax trust. The Board continued to provide seed capital loans of up to \$700,000 to existing seed capital companies until July 1, 1999 or until an amount of \$915,000 was reached; however, up to \$75,000 could have been used for administrative expenses. Beginning April 1, 1997, the proceeds from seed capital loans must be deposited in the coal tax trust. However, during fiscal 1998, \$250,000 of seed capital income, as well as \$150,000 of job investment loan income, must be used to fund the judges' retirement system. Also beginning April 1, 1997, and ending July 1, 1999, up to \$2.0 million in income and interest from research and development loans at Montana public universities may be granted to research and development (R&D) projects at the universities. After July 1, 1999, all repayment proceeds from both seed capital loans and R&D loans in excess of \$4.4 million must be deposited in the coal severance tax permanent fund. The amount of \$4.4 million presumably may continue to be loaned out by the Department of Commerce under a business investment strategy plan, which must be reported to the Fifty-sixth Legislature.

1999 Legislative Action

Beginning July 1, 1999, HB 260 imposed a new coal license tax on the contract sales price of coal and reduced the coal severance tax liability for coal producers by allowing a credit against the coal severance tax in the amount of 101.5 percent of coal license tax liability. Thus, coal producers would realize a reduction of 1.5 percent in tax liability on coal production. The total reduction in coal severance tax collections was expected to be \$20.7 million in fiscal 2000 and \$19.6 million in fiscal 2001. The new coal license tax was expected to generate \$20.4 million in fiscal 2000 and \$19.3 million in fiscal 2001. The legislation, in combination with HB 69 and SB 220, provided a new distribution of coal severance taxes and specified a distribution for the new coal license tax. Under the new distribution, none of the coal severance revenue would have been distributed to the permanent trust. Instead, 37.5 percent of the reduced coal severance tax revenue stream would have been deposited in the treasure state endowment trust fund, and 12.5 percent would have been deposited in a new TSEF regional water system account (SB220). The remaining distribution of the coal severance tax would be deposited as under previous law, except that the amount (1.3 percent) to long range building program debt service would have been directly deposited in the general fund as per HB 69. Coal severance tax revenue deposited in the permanent fund would be reduced by \$8.3 million in fiscal 2000 and would be by \$7.9 million in fiscal 2001. None of the new coal license tax would have been allocated to the permanent fund. Coal severance tax revenue deposited in the TSEF would have been reduced by \$3.6 million in fiscal 2000 and \$3.4 million in fiscal 2001. The revenue diversions in the each trust, as well as some of the revenue from the new coal license tax, would have been deposited into spendable accounts used for ongoing projects and payments associated with infrastructure loans and grants, agricultural seed capital, and research and commercialization loans and grants.

However, on January 20, 2000, the Montana Supreme Court found that HB 260 violated Article IX, Section 5, of the Montana Constitution and enjoined enforcement of the new coal producer's license tax. This rendered most of the legislation and appropriations meaningless. The decision did not affect the establishment of the research and commercialization expendable trust. Coordination with SB 220

also was not affected, allowing the establishment of the treasure state endowment regional water system trust and the distribution of coal severance tax to the trust and the TSEF remain intact.

HB 69 eliminates the distribution of coal severance tax revenue to the long range building debt service account that was used to pay bonds issued for the purchase of Virginia City and Nevada City property. Beginning July 1, 1999, the revenue is deposited in the general fund and the bond service payments are made by the general fund.

Beginning July 1, 1999, SB 220 created a new treasure state endowment regional water system fund into which is deposited 25 percent of one-half of all coal severance receipts. The other 75 percent of one-half of coal severance receipts flows into TSEF.

2001 Legislative Action

The Fifty-seventh Legislature in the 2001 session enacted HB 444 that appropriated \$990,000 for the 2003 biennium to the Department of Justice as a loan from the coal severance permanent fund. The purpose of the appropriation is to conduct the natural resource damage assessment and litigation and to pursue Montana's remaining natural resource damage claims and any appeals against the Atlantic Richfield Company. The resulting loss in transfers of trust interest earnings to the general fund is expected to be \$17,573 in fiscal 2002 and \$52,718 in fiscal 2003. Any reimbursements received must be deposited in the coal severance tax permanent fund. The legislation required a three-quarters vote of each house of the legislature.

Beginning fiscal 2004, HB 610 reduces the amount of total coal severance tax collections deposited in the treasure state endowment fund from 37.5 percent to percent 25.0 percent and increases the amount of total collections deposited to the permanent fund from 0 percent to 12.5 percent. These changes will result in greater interest earnings for the general fund and lower interest earnings for Treasure State Endowment Program beginning fiscal 2004.

In conjunction with HB 41, SB 495 changes the portion of school funding provided by the common school trust. The main points of the legislation are:

interest and income from the common school trust are deposited to a subfund of the general fund called the guarantee account;

the Department of Natural Resources and Conservation is authorized to purchase the mineral production rights from the common school trust;

1. a loan of up to \$75 million from the coal severance trust permanent fund will be used to purchase the mineral production rights and deposited in the common school trust (the actual transaction was \$46.4 million);
2. any mineral royalties from the purchased rights are deposited to the guarantee account;
3. after principal and interest payments on the loan used to purchase the mineral production rights are paid, the remaining money in the guarantee account is available for distribution to school districts; and
4. upon electorate approval of a constitutional amendment (contained in SB 493), the public school trust may be invested in private corporate capital stock.

Although it was estimated that the cost of the mineral production rights would be \$37.4 million, the actual amount loaned from the coal severance permanent fund was \$46.4 million. It is estimated that the loss of interest earnings that would have been deposited to the general fund is \$3.2 million in each

year of the 2005 biennium. The legislation required a three-quarters vote of each house of the legislature.

Coal tax revenue flowing into the permanent coal tax trust fund is also used to secure state bonds issued to finance water resource development projects and activities. From 1981 (when the legislature authorized this bonding program) to the end of fiscal 2001, \$147.3 million in water development projects throughout the state have been authorized with revenue from these bonds.

Coal tax revenue is first deposited into the school bond contingency loan fund within the permanent coal tax trust fund. The contingency fund provides up to \$25.0 million in loan guarantees for school district bonds certified by the Department of Administration as meeting certification standards, but for which subsequent litigation prevents collection of property taxes levied for debt service. The contingency fund has provided backing for \$24.607 million in school bonds for 16 schools. The average balance in the contingency fund has been slightly more than \$2.0 million.

In the August 2002 special legislative session the legislature passed House Bill 4 and House Bill 7. Combined, these bills changed the guarantee account from a subfund in the general fund to a state special revenue fund and statutorily appropriated the money for schools.

Common School Trust

Article X, Sections 2 and 3 of the Montana Constitution require that all royalties and other proceeds received from school lands granted to the state under the federal enabling act must be deposited in the common school trust fund and "shall forever remain inviolate, guaranteed by the state against loss or diversion." Article X, Section 5 requires that 95 percent of the interest from this trust be used for school equalization, with the remaining 5 percent reinvested in the trust. In addition, 95 percent of all rents, royalties, and other income received from leasing of school lands is to be used for public schools with the remaining 5 percent invested in the trust.

During the January 1992 special session, the legislature passed HB 3, which provided that 95 percent of the revenue from state timber sales (approximately \$4.9 million) be deposited in the SEA during the 1993 biennium, with the remaining 5 percent deposited in the trust.

The 1993 legislature passed HB 652, which continued the practice of diverting 95 percent of timber revenue to the SEA during the 1995 biennium. The loss in revenue to the common school trust during the 1995 biennium was approximately \$9.1 million. HB 667, also passed during the 1993 legislative session, continued this practice indefinitely. The loss of revenue to the common school trust during the 1997 biennium was approximately \$9.7 million.

1995 Legislative Action

HB 50 made permanent certain provisions regarding the sale of timber on state lands. HB 50 was expected to result in additional sales of timber during the 1997 biennium. However, additional costs associated with the sale of timber were also expected to be incurred. These costs were deducted from timber sale revenues.

HB 201, passed by the 1995 legislature, required the state to increase timber sales from state lands consistent with an annual sustainable yield of 45 million board feet to 55 million board feet, contingent on a study to determine the appropriate level of annual sustainable yield. HB 201 capped the amount of timber sale revenue deposited in the general fund (formerly the school equalization account, which

was abolished in SB 83) from the common school trust at an average annual sale value of 18 million board feet. Any excess timber sale revenue from the common school trust is to be deposited in the general fund, but "earmarked" for deposit in school districts' newly established technology acquisition fund to buy technological equipment and provide technical training for school district personnel.

HB 201 also affected timber sale revenue because it diverted timber sale revenue before it was deposited in the general fund to pay for costs associated with increasing timber sales. The total revenue effect was expected to be a loss of \$1.1 million to the general fund during the 1997 biennium.

HB 274, passed by the 1995 legislature, granted the Department of State Lands broader discretion to expedite sales of state timber in emergency situations and limited access situations. Effective in fiscal 1996, as a result of the natural resources reorganization bill (SB 234), the forestry function was transferred from the Department of State Lands to the Department of Natural Resources and Conservation.

SB 83 de-earmarked all interest from the common school trust and income earned on common school lands. Henceforth, these revenues flow into the general fund.

1997 Legislative Action

The 1997 legislature passed legislation that impacted the flow of timber revenue into the common school trust by appropriating timber revenue for use by the DNRC to enhance timber sales during the 1999 biennium. The amounts appropriated, \$1.2 million and \$1.3 million in respective years of the biennium, were diverted from the revenue stream before the allocation of 5 percent of revenue to the trust.

House Bill 2 appropriated anticipated timber sale revenue in excess of that associated with 18 million board feet for deposition in schools' technology acquisition funds. The purpose of the fund is to allow each district to buy technological equipment and provide technical training for school district personnel. The amounts appropriated were \$1.5 million in fiscal 1998 and \$2.8 million in fiscal 1999, or the amount of "excess" revenue in each year, whichever is less. However, no payment was made in fiscal 1999, but \$3.4 million is expected to be spent during the 2001 biennium.

1999 Legislative Action

SB 48 made significant changes in funding the Trust Land Management Division in the Department of Natural Resources and Conservation. The legislation diverted a portion of the following money (previously deposited into the corpus of the land trust funds) from ten land trusts administered by the department: 1) mineral royalties; 2) the proceeds or income from the sale of easements and timber (except timber from public school lands); and 3) 5 percent of the interest and income previously credited annually to the public school fund. The money was diverted to a state special revenue account to pay costs of administering state trust lands. The legislation provided limitations on the amount of diverted revenue and the amount of the appropriations: 1) the diverted revenue was limited to 1-1/8 percent of the book value balance in each of the nine nonexpendable trust funds on the first day of January preceding the new biennium and 10 percent of the previous fiscal year revenue deposited into the capitol building land grant trust fund; and 2) appropriations of the money were limited to 1-1/8 percent of the book value balance in the nine nonexpendable trust funds on the first day of January preceding the new biennium and 10 percent of the revenue deposited in the capitol building land grant trust fund in the last completed fiscal year prior to the new biennium. In HB 2, the legislature replaced \$7.1 million of general fund appropriations with state special revenue provided by this legislation.

Therefore, deposits to land trusts (primarily the Common School Trust) were reduced by \$7.1 million over the biennium, approximately \$3.5 million per year.

2001 Legislative Action

Although SB 495 potentially could have increase the balance of the common school trust by \$75 million due to the sale of its mineral production rights, the increase depended on the amount of rights purchased by DNRC and the sale price. The actual purchase price of the mineral production rights was \$46.4 million and this amount was deposited to the trust. Since future royalties from any sold mineral production rights are no longer deposited in the common school trust, the future growth of the trust is severely curtailed. For further information and analysis of Senate Bill 495, contact the Legislative Fiscal Division for a copy of the two-part report: "Senate Bill 495 – Implementation, Impacts and Implications".

Resource Indemnity Trust

Article IX, Section 2 of the Montana Constitution and Title 35, Chapter 38, MCA, require that certain resource extraction taxes be placed in a trust. The principal of the resource indemnity trust "shall forever remain inviolate in an amount of one hundred million dollars (\$100,000,000), guaranteed by the state against loss or diversion." Once the principal of the trust reaches \$100 million, any additional tax revenue may be appropriated.

During the July 1992 special session, the legislature imposed a one-year surtax on resource indemnity tax liability and allocated collections from the surtax to the general fund. During the 1993 legislative session, the legislature passed HB 608 that decreased the amount of resource indemnity and groundwater assessment (RIGWA) tax proceeds deposited in the trust during the 1995 biennium from 85.9 percent per year to 55.9 percent, or approximately \$5.0 million. The bill further reduced the amount of RIGWA tax revenue deposited in the trust to 45.9 percent beginning July 1, 1995. During the 1995 session, the legislature replaced a portion of RIGWA tax proceeds with oil and gas tax proceeds due to a bill to simplify oil and gas taxes (SB 412). Also, the legislature diverted for other purposes the metal mines license tax proceeds that previously were deposited to the trust.

1997 Legislative Action

SB 377 reduced the growth rate in the ending fund balance of the RIT trust by diverting \$200,000 per year from RIGWA tax inflows and 8.5 percent from metalliferous mines license tax revenue to a newly created orphan share account. The reduction of inflow into the trust in each year of the biennium as a result of these diversions was \$674,000 and \$743,000. The orphan share account is used to: 1) fund remedial actions on the portion of hazardous waste sites for which there is no responsible party; and 2) pay for DEQ transaction costs associated with defending the orphan share proportions.

1999 Legislative Action

SB 49 and SB 492 increased the allocation of the RIGWA tax and the RIT share of the oil and gas production tax to the RIT. The ending fund balance at the end of the 2001 biennium is expected to increase by \$162,000 as a result of the legislation. The legislation also eliminated the allocation of RIGWA tax revenue to the RIT beginning July 1 of the first year following the date that the governor by executive order certifies to the Secretary of State that the RIT balance has reached \$100 million.

2001 Legislative Action

The RIT balance reached \$100 million amount in fiscal 2002 and the balance was certify by the governor. Therefore, no additional revenue is deposited in the trust beginning fiscal 2003. The revenue

estimates showed that there would be an estimated \$101.1 million in the trust balance by the end of fiscal 2003. Since any additional tax deposits over the \$100 million may be appropriated by the legislature, the 2001 legislature enacted the following legislation that uses all of the excess revenue: 1) SB 326 authorizes the transfer of \$500,000 to the noxious weed state special revenue account for distribution to counties (the money is appropriated in HB 2); 2) HB 2 transfers and appropriates \$540,000 to purchase securities for water treatment at the former Zortman and Landusky mines; and 3) HB 2 transfers and appropriates \$120,000 for the Clark Fork River task force (established in HB 397). Therefore, it is likely that the trust balance at the end of fiscal 2003 will be \$100 million.

The August 2002 special legislative session reduced the transfer to the noxious weed state special revenue account for counties to \$300,000.

Tobacco Settlement Trust

Due to passage of Montana Constitutional Amendment 35 in November 2000, the legislature is required to dedicate not less than 40 percent of tobacco settlement money to a permanent trust fund. The remainder of the money was deposited into the general fund. Since the legislature did not pass legislation establishing the exact percentage to be deposited to the trust fund, the revenue estimate assumes 40 percent. Interest earnings from the trust fund are to be distributed: 1) 90 percent for appropriation by the legislature for tobacco related disease prevention programs and state programs providing benefits, services, or coverage that are related to the health care needs of the people of Montana; and 2) 10 percent to the trust. Money in the trust fund can be spent if approved by two-thirds of each house of the legislature. Appropriations of principal, income, or interest from the trust fund cannot be used to replace state or federal money used to fund tobacco disease prevention programs that existed on December 31, 1999.

Montana receives revenue as a settling party to a Master Settlement Agreement with four original tobacco companies and 34 subsequent companies that ended a four-year legal battle that included 46 states, and six other entities. Montana is eligible for four types of payment: 1) reimbursement for legal costs (received December 1999); 2) five initial payments (two in fiscal 2000 with an additional one per year in fiscal 2001, 2002, and 2003); 3) on-going annual payments; and 4) strategic contribution payments (from fiscal 2008 through 2017). The Master Settlement Agreement places no restrictions on how states are to spend the money. Contrary to popular belief, the payments will be received in perpetuity.

The total amount of tobacco settlement funds available to Montana may be affected by a number of adjustments. The two most important are the adjustments for inflation and volume of cigarettes shipped nationally. The amount of Montana's annual share will increase by a minimum amount of three percent or more if inflation is greater than three percent. The amount will decrease if the number of cigarettes shipped nationally decreases and will increase if the number increases.

The 2001 legislature enacted SB 129 that established a Montana tobacco settlement non-expendable trust fund to implement Article XII, Section 4, of the Montana Constitution. The legislation also provided criteria to govern the purposes for which the interest, income, and principal of the trust may be appropriated. It did not establish a statutory percentage of the tobacco settlement dedicated for deposit in the trust fund.

Due to passage of Initiative 146 by the electorate in November 2002, beginning fiscal 2004, 32 percent of the total tobacco settlement money funds tobacco prevention programs and 17 percent funds the

Children's Health Insurance Program. The remaining 11 percent of the total settlement money is deposited to the general fund.

STATUTORY TRUSTS

Education Trust

From fiscal years 1976 through 1986, a portion of the revenue from the coal severance tax was allocated to an education trust for the support of education. The legislature appropriated the corpus of this trust to the school equalization account during the period of fiscal 1987 through 1990. Since fiscal 1990, the education trust has not received revenue from any source and its balance is zero.

Parks Acquisition/Arts Protection Trust

During most of the years since 1979, a portion of the coal severance tax has been earmarked for the parks acquisition trust. During the late 1980s, the flow of revenue into this account was diverted to the general fund. However, the principal began to increase again in fiscal 1990. Prior to fiscal 1992, two-thirds of the interest from this trust was statutorily allocated for acquisition and operation of state parks, and one-third was allocated for protection of works of art in the state capitol and other cultural and aesthetics projects.

The 1991 legislature split the principal of this trust into two separate trusts: a parks acquisition trust and an arts protection trust. During the 1993 biennium, the coal tax revenue that would have flowed into the parks acquisition trust (1.267 percent) was spent for maintenance of parks and historic sites, along with the interest from the trust. HB 687, passed during the 1993 legislative session, continued this practice for the 1995 biennium, allocating \$1.6 million from the trust to current operations. In the 1997 biennium, the coal tax revenue allocation was again deposited in the trust. SB 27, passed by the 1995 legislature, increased the allocation to the parks acquisition trust from 1.267 percent to 1.270 percent.

In fiscal 1992, 0.633 percent of coal severance tax revenues was deposited in the arts protection trust, with the trust interest continuing to be used for protection of works of art and for cultural and aesthetics projects. During the January 1992 special session, the legislature diverted a portion of the revenue that would have flowed into the arts protection trust in fiscal 1993 to fund the operations of the Montana Arts Council. Beginning in fiscal 1994, these revenues were again deposited in the trust. SB 27, passed by the 1995 legislature, decreased the allocation to the arts trust from 0.633 percent to 0.63 percent.

1997 Legislative Action

The 1997 legislature amended the allocation of coal severance taxes under Section 15-35-108, MCA. HB 5 eliminated the 0.63 percent distribution of coal severance tax to the cultural and aesthetic trust during the 1999 biennium only. The legislature appropriated \$3.9 million from the cultural trust for the immediate purchase of the Virginia City and Nevada City. This appropriation resulted in a loss of trust interest revenue that otherwise would be used to fund C&A projects in the state during the 1999 biennium. In order to compensate for the lost interest, the legislature allocated 0.87 percent of coal severance tax revenue to the C&A projects account, and eliminated the 0.63 percent of coal severance tax revenue that had been deposited in the cultural trust. The remaining 0.24 percent of coal taxes allocated to the C&A project account was previously part of the flow into the general fund. After the 1999 biennium, similar amounts of coal severance tax revenue were diverted from the C&A projects account and again flowed to the general fund.

1999 Legislative Action

HB 260, HB 69, and SB 220 reduced coal severance tax revenue and replaced it with coal license tax revenue. The aim of the legislation was to hold the revenue flow into the arts and parks trusts as under current law. However, the arts and parks trusts lost around \$25,000 over the biennium.

However, the January 20, 2000 decision of the Montana Supreme Court that found HB 260 violated Article IX, Section 5, of the Montana Constitution rendered the above changes meaningless.

2001 Legislative Action

In the August 2002 special legislative session, for fiscal 2003, the legislature temporarily diverted the parks acquisition trust 1.27 percent allocation and the cultural trust 0.63 percent allocation to the general fund. Beginning fiscal 2004, the allocations resume.

Noxious Weed Management Trust

During the period fiscal 1986 through 1992, at least one-half of the collections from a 1 percent surcharge on the retail sale of herbicides was deposited in the noxious weed management trust fund. The remaining collections were spent for weed control grants. The interest earned on the trust is retained in the trust. After the principal of the trust reached \$2.5 million in fiscal 1992, all herbicide surcharge collections and the interest earned on the trust became available for weed control grants.

1995 Legislative Action

SB 321, passed by the 1995 Legislature, increased the amount of the gasoline tax revenue allocated to the snowmobile account from 23/64 of one percent to 15/28 of one percent. Beginning in fiscal 1996, one percent of the amount deposited in the snowmobile account is deposited in the Montana noxious weed control trust administered by the Department of Agriculture.

1999 Legislative Action

For the 2001 biennium, SB 164 transferred \$1.125 million per year to the noxious weed trust from the highway non-restricted account in 15-70-125. As a result, the ending fund balance in the trust will almost double by June 30, 2002.

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